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U.S. PROPOSALS ON INTERNATIONAL DEBT CRISIS

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HEARING

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

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U.S. PROPOSALS ON INTERNATIONAL DEBT CRISIS

TUESDAY, OCTOBER 22, 1985

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The committee met, pursuant to call, at 1:30 p.m., in room 2128, Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the committee) presiding.

Present: Chairman St Germain; Representatives Gonzalez, Annunzio, Mitcheli, Fauntroy, Neal, Hubbard, LaFalce, Lundine, Oakar, Barnard, Schumer, Lehman, Kaptur, Levin, Torres, Kleczka, Gordon, Manton, Wylie, McKinney, Leach, Shumway, Parris, McCollum, Wortley, Roukema, Bereuter, Dreier, Hiler, Ridge, Bartlett, Roth, Chandler, McCandless, Grotberg, Kolbe, and McMillan.

Chairman ST GERMAIN. The committee will come to order.

I have been informed that our ranking minority member, Mr. Wylie, will be delayed slightly. He asked me to apologize to the Secretary, but certainly he wanted us to proceed with the business of the day.

Today the Committee on Banking, Finance and Urban Affairs welcomes, and I might add parenthetically, I know for the first time, Secretary James A. Baker III, who will report on the U.S. proposals advanced at the annual IMF World Bank meeting held recently in Seoul, Korea.

Before asking Mr. Wylie, who as I said will have to be delayed slightly, and Mr. Lundine, chairman of our Subcommittee on International Development and Mr. Neal, chairman of our Subcommittee on International Finance, Trade and Monetary Policy for their remarks, I would like to offer a few of my own.

Will the administration be asking the Congress' help in carrying out its plan to actively involve itself in the international debt crisis? Will the proposals contained in the "Program for Sustained Growth" require the authorization and appropriation of additional U.S. funding—particularly for the World Bank, if not also the IMF?

If so, I and many others must be convinced of the need.

Mr. Secretary, you were at the White House in 1983 when we were able to pass the IMF funding bill by a mere six votes. Later we combined this legislation with a substantial housing bill as well as a tough antiapartheid language, both of which were objectionable to the administration, however, they were necessary in order to have the conference report adopted.

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To refresh your memory, many Members of Congress could not understand—and still do not—how an austerity program imposed by the IMF on lesser developed countries could increase U.S. exports to these countries. When the IMF imposes austerity programs to curtail lesser developed countries' imports, it is obvious that these programs curtail our exports. Thus, it is difficult to understand how this program can be sold as some kind of back door assistance for U.S. exporters.

Mr. Secretary, many Members of Congress, and many both in and out of the banking community, labeled the last IMF bill, and I hate to use the word, but they call it a bailout bill for the big banks. Now, Mr. Secretary, many question the radical change you are proposing for the World Bank. They say these additional moneys will not be used for new projects to improve conditions for the entire population in the Third World, but instead will be used for the repayment of existing and future debt.

This brings me to another administration proposal, for a balanced budget in 1990, courtesy of Gramm-Rudman. Now, I ask you what worthy domestic programs will have to be cut in order to balance the budget and support the administration's newest IMF-World Bank funding request? I assure you that the Congress will never allow domestic programs to take a back seat in the budget process.

In closing, I want to stress that this Member will have to be convinced that this program is absolutely necessary, that it is not a further tightening of the economic screws on those developing countries that can least afford it. And that it is not taking funds from domestic projects, and programs of crucial importance to the American people.

I would like to add one more slight note. I note that there have been negotiations and discussions with some of the leading banks in the country, about the provision of an additional $20 billion in credits over the next 2 or 3 years.

I am also told, however, that these banks are attempting to exact a little quid pro quo, and I hope that you, the Secretary, will continue what I understand you have been doing, and that is to say to them they have an obligation to do this and they should not be looking to us, to the Congress, to the taxpayers of the United States for total guarantees, not only on this additional debt, but on some of the prior debt that exists.

At this time, I will call on the next ranking member, Mr. Neal, if he has an opening statement.

Mr. NEAL. Thank you, Mr. Chairman.

I certainly want to join the chairman in welcoming the distinguished Secretary here today. I imagine you will cover some of this in your comments, but let me digress and say first I want to bring you up to date a little bit.

I notice in the sheet we got concerning what you were going to talk about today did not mention the mixed credits proposal. I wanted you to know we already had a day's hearing on it, we have another day scheduled tomorrow and we intend to go to markup on it pretty soon.

To go to markup on it may not be precise because we don't know quite what we will go to markup on yet. But I do believe since this

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committee has passed twice in the past proposals that are similar to this, once a war chest bill, once a mixed credit bill, there would be a fairly strong sentiment for such a proposal, the details to be worked out in the markup. But back to a question I hope you will touch on as you make your statement, and that has to do with what is new in your proposal.

As I read it from press reports, there is really only one new element and that has to do with replacing what some characterize as austere policies on the part of Governments, with what you call growth policies, and my question really has to do with what kind of balance you see for these two kinds of proposals and what you would think would be an incentive to private banks to make more loans in the countries if they are not following some sort of restraint in their policies that would let them pay these loans off in the future.

As I am sure you know in the past, most bank lending to the lesser developed world has been based on the option that governments would take the IMF program seriously and follow policies that would let them work their way out of debt.

If growth means they are running up huge budget deficits like we are doing, I wouldn't think that would encourage too much more private lending.

Thank you, Mr. Chairman.

Chairman ST GERMAIN. The Chair calls on Chairman Lundine.

Mr. LUNDINE. Thank you very much, and thank you very much for holding this hearing on a subject that our subcommittee has been working on for some time.

Mr. Secretary, I commend you and your associates and the administration for the innovative recognition that there are very serious debt problems and that austerity alone is not the answer. Economic growth is, and the United States under your leadership is now supporting a policy of economic growth for the developing nations.

The need for the administration to explain and to sell its program is evident even by the opening remarks of our full committee chairman here today, and I am sure others as well.

We are interested in its details, particularly the share of the burden that the various parties are going to be asked to shoulder, and whether the administration is committed to providing whatever resources are necessary to make it work and which may be needed by the World Bank and the developing countries.

I pledge that we will work with you in promoting an equitable and effective response to the debt and growth crisis. As you know, we have indicated that in our subcommittee report, which preceded by a few days your very bold announcement. We look forward to continuing to work with you.

Mr. Chairman, I ask unanimous consent that my entire statement be made a part of the record.

Chairman ST GERMAIN. Without objection so ordered.

[The opening statement of Congressman Lundine follows:]

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OPENING STATEMENT BY
CONGRESSMAN STAN LUNDINE

Committee on Banking, Finance, and Urban Affairs
October 22, 1985

Mr. Chairman, I want to thank you for holding this hearing today. As you know, the Subcommittee I chair has been looking carefully at the issues that will be addressed today by Secretary Baker.

It is important that the full Banking Committee have this timely opportunity to hear directly from the Secretary the details of the new proposals the United States laid on the bargaining table at the World Bank/IMF meetings in Seoul.

Secretary Baker, I want to commend you for the initiative taken at those meetings in Seoul. Your statements and the specific proposals you advocated there represent a refreshing new departure for the Administration.

Your realization that endless programs of austerity alone will not solve the problem of debt, and your explicit statements in support of expanded growth and economic opportunity in the developing nations, are right on target. They represent the kind of leadership which the United States should demonstrate more often in these international debates.

At the same time, I must say in all candor that the package of proposals advanced in Seoul will require some sustained salesmanship to succeed, and some important questions about the details of the package must be answered. As you well know, Mr. Secretary, there is a wide divergence of views about the multilateral banks and the world financial system here in Congress and in the public at large. Both the Subcommittee I chair and this full Committee have historically been supportive of their mission, but that is not true in all quarters.

Your task, Mr. Secretary, if your initiative in Seoul is to have lasting meaning, is to aggressively make the case for these proposals and secure the broad political support for the World Bank, the other development banks and for the developing countries themselves that will be needed for these proposals to take life. I can pledge to you today that those of us in the Congress who support a fair and effective resolution to the debt crisis will work with you in refining and promoting these ideas.

I am happy to see that you have already begun working toward that end. Your timely appearance here indicates your desire to secure the support of this Committee and the Congress. Your meetings with representatives of the major creditor banks in the last few days likewise indicate that you are at work.

Both today and in other forums, certain important questions about these new initiatives must be answered. One of the foremost is about the basic equity of the program for sustained growth. There is a lingering suspicion, fueled in part by the past track record of the Administration, that this new initiative remains too harsh in spirit toward the developing countries and too lenient in its particulars toward the commercial banks.

This Committee and others will want to explore fully whether the private banks are being asked to shoulder their full and fair share

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of the burden of resolving the international debt crunch we find ourselves in today.

Another question which must be squarely faced is whether the Administration is adequately committed to making the real, tangible resources available as they are needed to help the developing countries do what is being asked of them.

In this regard, it would be important to hear that President Reagan himself is committed to this new initiative and will speak publicly, in the very near future, on behalf of the program the United States enunciated in Seoul.

There are other, more detailed questions about the mechanics and workability of the new package for dealing with debt and development put forward in Seoul. We will address those today and in the coming weeks. I look forward to working with the Administration to achieve what I hope is our common goal of an equitable and effective response to the debt and growth crisis which is stunting the economic life not only of the developing nations but also of our people right here in this country.

Thank you for coming this afternoon, Mr. Secretary.

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Chairman ST GERMAIN. The Chair now recognizes the ranking minority member on the International Development Institutions and Finance Subcommittee, Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman.

I want to join in welcoming Secretary Baker to the committee today. We are pleased and honored by your presence here. Prior to your departure for Korea, Mr. Lundine and I visited with you, we discussed the report to which Mr. Lundine just made reference and also other important issues effecting our international economy.

I would like to commend you as others have already this afternoon for taking the bold leadership position you enunciated at Seoul.

I think the world needed the reaffirmation of the U.S. political and economic leadership in international economic affairs. I look forward to learning the details of the complicated proposals that you made at the IMF World Bank meeting in Seoul. Once again welcome.

Thank you, Mr. Chairman.

Chairman ST GERMAIN. The Chair recognizes Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

I too join my colleagues in welcoming before the committee Secretary Baker. I appreciate the Secretary appearing here today to brief the committee on the annual meeting of the World Bank. Before I go any further, let me state that I oppose any further contribution to the World Bank or IMF by the U.S. Government.

At a time when the United States is running record deficits and the national debt is spilling over $2 trillion, how can we hand over $2 billion to the World Bank? How can the administration advocate a balanced budget by 1991 and scream about too much spending when it wants to give $2 billion to the World Bank.

And it should be great news to hardpressed farmers who have been told by the administration that it won't bail them out, that in the last 4 years, the World Bank has had a 400-percent increase in loans to Communist countries, with much of the money being supplied by the United States. Perhaps the World Bank should adopt the Nebraska football team's slogan, "Go Big Red."

How can we justify not giving loans to farmers to save their farms when the World Bank gave a $47 million loan, interest free, 50-year loan to Communist China for development of its state farms. Certainly the Bible teachs us to forgive our enemies, but the Bible says turn the other cheek, not turn the other check.

The World Bank claims it gave the highly favorable loan terms to encourage borrowing. Maybe next time the Bank can give a free toaster to every Chinese farmer.

But do U.S. funds really end up being used for the intended purpose or are they just another bailout of the big U.S. banks whose loans to other countries are in default? We give Costa Rica $200 million a year in foreign aid and what happens to the money? Here is what the President of the country's central bank says happens to the money. "We are recycling money from the U.S. Government and paying it out to U.S. banks." It should be noted that Costa Rica owes $3.6 billion to private banks.

But what shocks me the most about our role in funding the world is the amount of money lent to Communist countries. This

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year $13.4 billion of all World Bank lending will go to Communist countries. Since 1981 China, Romania, Ethiopia, Yugoslavia, and Hungary have received more than $6 billion—including almost $2 billion this year.

We spend billions of dollars fighting communism around the world and billions upon billions every year on weapons systems to protect us against Communists. We are being asked to fund a star wars project that will shoot down Communists missiles in space. By why should the Communists attack us in space when they are doing a great job of attacking us in the wallet? We need to guard our wallet, not our space.

I will vote against any increased funding for the World Bank which can already lend $13 billion this year solely based on loan repayment and interest income.

There is one group in this country that is vitally concerned about giving away money to foreign countries who thumb their noses at the United States. That group is called taxpayers. I suggest that any Member of Congress who has taxpayers in his district should also vote against increased funding of the World Bank.

Chairman ST GERMAIN. Mr. Secretary, the Chair would like to inform everybody that we are indeed grateful to the Secretary and for the fact on very short notice—I think it was last Wednesday or Thursday afternoon we met—I asked the Secretary if he would be gracious enough to come before the full committee on this matter because it is of extreme importance not only to the committee but to the country at large. He did rearrange his schedule. For that we are grateful.

I also mentioned, Mr. Secretary, you are now in the ranking of Paul Volcker and Lee Iacocca as far as the number of still photographers who are not that still when they are jumping around in front of you. I hope you can manage to give your statement without too much distraction.

Mr. SCHUMER. Mr. Chairman, I have an opening statement which I simply would ask unanimous consent be inserted in the record.

Chairman ST GERMAIN. Is there objection? The Chair hears none.

[The opening statement of Congressman Schumer follows:]

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STATEMENT OF
THE HONORABLE CHARLES E. SCHUMER

Secretary Baker deserves praise from this Committee, and from everyone concerned about the stability of the international financial system for elevating concern over the debt crisis to the highest level of the cabinet. His attitude is a refreshing change from that of his predecessor, whose response was "what, me worry" well after bankers and other officials recognized the urgency of the problem.

But somewhere between his concern and his plan, I am afraid that the Secretary has gone astray. The plan, loftily titled a "Program for Sustained Growth," has been hailed in some parts as a bold new initiative. But after examining the plan it seems to me that Secretary Baker's plan has adopted the theme from the President's reelection campaign -- "Stay the Course" -- because all I see is more of the same.

The crown jewel of the program is a $20 billion increase in private commercial bank lending to Third World debtor countries over the next three years. Put simply, we are asking our nation's commercial banks to throw good money after bad, at a time when they are already up to the gills in shaky third world loans.

What will these loans be used for? Ostensibly, they are to be used to promote growth, but it seems more likely that they will be used simply to pay interest on the current outstanding debt. The plan contains no provisions calling for lower interest rates on these loans. But no plan can be successful unless it calls for stretching out old short-term, market rate loans to long-term, lower interest loans. Debtor nations are already squeezing their economies dry just to pay interest, and many are falling behind. If we extend them new loans but do nothing to adjust the rate, any new loans are likely to be used simply to pay interest, which, in turn, only adds to their long-term debt burden.

The program also calls for adoption by debtor countries of economic and structural reforms, supported by international financial institutions. What's new about this? Austerity is already the official policy of the I.M.F., and austerity by any other name will be just as counterproductive, just as likely to destabilize fragile democracies among our allies, just as likely to lead to widespread civil disturbances, and, ultimately, just as likely to be ignored by debtor countries

The Secretary's plan also calls for $5 billion in new lending by the World Bank. This will probably help, but, realistically, considering that Latin American nations already have a combined debt of $300 billion, what good will it do unless interest rates are lowered on present debt?

As a Congressman from New York City, I know what it's like to throw good money after bad. We did it in the City for years, blind to the real problem and necessary solutions until it all came crashing down. "Growing out of debt" sounds like a great idea. If it works as well in Latin America as it has with our government's deficit, then it is not too soon to start looking beyond the Secretary's program to the next strategy.

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Chairman ST GERMAIN. We would like to hear at this point from Secretary Baker. We will put your entire statement in the record. You may proceed.

STATEMENT OF HON. JAMES A. BAKER III, SECRETARY OF THE TREASURY

Secretary BAKER. Thank you, Mr. Chairman.

I have a summary of the full statement. If you would put the entire statement in the record I would appreciate it.

Chairman ST GERMAIN. Without objection.

Secretary BAKER. I apologize first of all for being hoarse and I will do the best I can. I have a little laryngitis.

I am pleased to be here and have the opportunity to appear before you this afternoon to discuss the meetings of the International Monetary Fund and the World Bank and the proposals we advanced at the annual meeting for strengthening the international debt strategy.

Your recent subcommittee report contains a number of thoughtful ideas and provides solid evidence the Congress and the administration are close on those issues.

Considerable progress has been made during the past 3 years in addressing the immediate debt servicing problems of the developing nations and in improving growth prospects in the industrial countries.

However, it is clear that some problems have arisen, particularly with regard to insufficient domestic reforms in the principal debtors and a sharp reduction in commercial bank lending.

Those problems need to be addressed if progress is to be sustained. We must build upon our current debt strategy while continuing to tailor our approach to the particular circumstances of each individual country.

Our proposed program for sustained growth in the principal debtor nations incorporates three essential and mutually reinforcing elements:

First and foremost, the adoption by principal debtor countries of comprehensive macroeconomic and structural policies to promote growth and balance-of-payments adjustment and to reduce inflation;

Second, a continued central role for the IMF in conjunction with increased and more effective structural and sector adjustment lending by the multilateral development banks;

Third, increased lending by the private banks.

An essential prerequisite to resolving the economic difficulties of the debtor countries is their adoption of sound fiscal, monetary, and exchange rate policies to reduce both external and domestic imbalances.

For those countries which have implemented measures to address these imbalances, a more comprehensive set of policies can now be put in place, including both macroeconomic policies and longer term structural policies to promote growth.

These policies should include market-determined interest rates, wages and prices, as well as further efforts to reduce inflation and budget deficits, increased reliance on the private sector, more

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supply-side actions to mobilize domestic savings and to facilitate efficient investment, and greater emphasis on market opening measures to encourage foreign direct investment, capital inflows, and trade.

The IMF and the multilateral development banks have an important role we think to play in this process. Our debt strategy has emphasized the need to reduce both external and domestic imbalances to help lay the basis for longer term growth. This has required a strong central role for the IMF. That central role should continue.

Increased coordination with the World Bank will also, however, be needed. There is ample room to expand the World Bank's fast disbursing structural and sector adjustment lending in support of growth-oriented policies and institutional and sectoral reform.

Efforts to expand the World Bank's cofinancing operations should also be pursued vigorously.

Since some of the most serious debt problems are found in Latin America, special emphasis should also be placed on strengthening the Inter-American Development Bank's policies to enable it to be a more effective partner in support of growth-oriented structural reform.

We believe a serious effort to develop the programs of the World Bank and the IDB could raise their disbursements to principal debtors by 50 percent, to $9 billion annually in 1986 to 1988 or $27 billion over 3 years.

There must also be a corresponding commitment by the banking community to help support the principal debtor countries as they make the transition to stronger sustained growth. Our assessment of the commitment required by the banks to principal troubled debtors would be net new lending in the range of $20 billion for the next 3 years.

In addition, countries now receiving adequate financing from commercial banks on a voluntary basis should continue to do so, provided that they maintain sound economic policies.

The U.S. regulatory agencies are on record as stating that in appropriate circumstances new lending can help to improve the quality of outstanding credit. In seeking a commitment from commercial banks, I would especially ask their boards of directors to take a direct interest and a longer term view of the potential benefits. If the program for sustained growth works, all of the participants, including the banks, will be better off.

If it does not succeed, the banks as well as the borrowing countries will be worse off. So, too, will the economies of the major industrial nations.

If developing countries implement growth-oriented reform; if commercial banks provide adequate increases in net new lending; and if increased demand for quality World Bank lending demonstrates the need for increased World Bank capital, and only in those events, would we be proposing to look seriously at the timing and the scope of a general capital increase for the World Bank.

The reaction to our proposal to strengthen the debt strategy so far has been positive and has been encouraging. Obviously, a proposal of this scope and magnitude requires careful consideration by all interested parties.

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The U.S. banking community generally recognizes its interest and reponsibility in supporting sustained growth in the principal debtor nations. I am confident it will do its part by significantly increasing net new lending.

Each of the principal debtor nations in our view should begin to consider comprehensive policy packages which would be developed on a case-by-case basis with the support of the international financial institutions.

In addition to the principal debtors, and that is what I have been talking about up to now, and that is really what our proposal covers, there is another group of countries, the very low income developing nations primarily in sub-Saharan Africa, which face protracted balance of payments problems and are more dependent on official financing flows.

The United States believes that the $2.7 billion available from the IMF Trust Fund reflows through 1991 present us with a unique opportunity to provide balance of payments support for low-income countries implementing programs promoting structural adjustment and growth. The Interim Committee endorsed this position.

There was also a consensus on the importance of the Fund working in close collaboration with the World Bank. However, we are also prepared to consider a somewhat bolder approach, to encompass joint IMF and World Bank programs and financing. Such joint programs would be a major practical step in insuring consistent policy advice and coordinated financial support. We will be pursuing this idea in the weeks ahead.

We have also agreed to begin negotiations on a replenishment of the International Development Association, a key institution for encouraging growth and development in the least creditworthy countries.

In summary, the Seoul meetings reinforced the international community's commitment to further action on the part of both developed and developing countries to promote sustained economic growth, to maintain the necessary flows of capital, and to preserve and expand open markets.

The approaches we recommended in Seoul have broad support and form a solid basis from which the international community will be able to respond positively to the difficult and complex debt problems we are likely to face over the next few years.

Since I believe these proposals accord well with key suggestions and ideas in your subcommittee report, I look forward to hearing your views. Thank you.

[The prepared statement of Secretary Baker follows:]

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STATEMENT OF THE HONORABLE
JAMES A. BAKER, III
SECRETARY OF THE TREASURY

BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
OCTOBER 22, 1985

Mr. Chairman, Members of the Committee:

I am pleased to have the opportunity to appear before you this morning to discuss the annual meetings of the International Monetary Fund and the World Bank. The recent report by your Subcommittee on International Development Institutions and Finance on Dealing with Debt, Rekindling Development contains a number of ideas that entered into our thinking before the meetings and provides solid evidence that the Congress and the Administration are close in their views on international financial issues.

For forty years, the International Monetary Fund and the World Bank have been focal points for the international community's effort to instill soundly based growth and development in the world economy. These two international financial institutions have compiled an impressive record of accomplishment, and the United States remains firmly committed to working with other members to maintain their strength and effectiveness.

During preparations for the annual meetings, it became clear to us, as to your Subcommittee, that the key issue before the world financial community was our ability to foster stronger, sustained growth in developing nations. Considerable progress has been made during the past three years in addressing the immediate debt servicing problems of the developing nations and in improving growth prospects in the industrial countries -- an essential foundation for growth in the developing world.

Indeed, since 1982 the aggregate current account deficit of the developing countries has been reduced by more than half; their growth rate has doubled; and their exports have improved dramatically. This progress is attributable to adjustment

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measures within the developing countries themselves, economic recovery in the industrial nations, and financial support from the commercial banks and the international financial institutions. The case-by-case international debt strategy adopted three years ago has contributed significantly to this progress and, on balance, has worked very well.

However, problems have arisen in certain areas. These include the slippages in the domestic economic programs of several of the principal debtor nations, particularly with regard to their efforts to reduce inflation and to cut government budget deficits. Net new lending by the commercial banks has also declined abruptly, despite the significant improvement in current account positions, reflecting a growing reluctance by many banks to participate in new money and debt rescheduling packages. The decline in new lending to nations which are performing well is especially disturbing, since it undercuts both their ability and their resolve to pursue essential economic reforms.

These problems need to be addressed if progress is to be sustained. We must build upon, and strengthen, the current debt strategy, while continuing to tailor our approach to the particular circumstances of each individual country. Our approach must encompass greater emphasis by the debtor nations on policies which will improve growth prospects for the future, as well as enhanced policy and financial support from the international financial institutions and the banking community.

I proposed such an approach in my statement to the Joint IMF/World Bank Annual Meeting. Our three-point "Program for Sustained Growth" in the principal debtor nations constitutes, in essence, the "next phase" of the global debt strategy. It will require additional, concerted efforts to improve the prospects for growth in these nations, with long-term benefits for the entire global community.

I. The U.S. "Program for Sustained Growth"

Our proposed "Program for Sustained Growth" in the principal debtor nations incorporates three essential and mutually reinforcing elements:

> First and foremost, the adoption by principal debtor countries of comprehensive macroeconomic and structural policies to promote growth and balance of payments adjustment, and to reduce inflation;
>
> Second, a continued central role for the IMF, in conjunction with increased and more effective structural and sector adjustment lending by the multilateral development banks (MDBs); and

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Third, increased lending by the private banks.

In short, we believe that there must be greater emphasis on both market-oriented economic policies to foster growth, and adequate financing to support it. The concerns we have addressed and the proposals we have made accord well with the ideas and recommendations in your Subcommittee's report. Permit me to expand briefly on the actions that would be required by each participant in this three-point approach.

(1) Action by Principal Debtors

An essential prerequisite to resolving the economic difficulties of the debtor countries is their adoption of sound fiscal, monetary, and exchange rate policies to reduce both external and domestic imbalances. For those countries which have implemented measures to address these imbalances, a more comprehensive set of policies can now be put in place, including both macroeconomic policies and longer-term supply-side, market oriented, policies to promote growth.

Sustained growth in these countries will depend in large measure on their ability to generate greater domestic savings, to encourage the investment of those savings at home, and to attract additional investment from abroad. In a number of these countries, domestic savings have been sent and held abroad rather than being used at home. In addition, restrictions on profit remittances have discouraged equity investment and increased reliance on foreign borrowing, which increases the debt service burden. And inefficient public sectors are absorbing resources which could be used more productively in the private sector.

As a practical matter, it is unrealistic to call upon the support of voluntary lending from abroad when domestic funds are moving in the other direction. Capital flight must be reversed if there is to be any real prospect of additional funding.

Policies to address these problems should include market-determined interest rates, wages and prices as well as further efforts to reduce inflation and budget deficits. We would also like to see:

- increased reliance on the private sector, with a reduction in role of governments in the economy, to help increase employment, production and efficiency;

- more supply-side actions to mobilize domestic savings and facilitate efficient investment, by means of tax reform, labor market reform and the development of financial markets; and

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- greater emphasis on market-opening measures to encourage foreign direct investment and capital inflows, as well as to liberalize trade.

(2) Role of the International Financial Institutions

The IMF and the multilateral development banks have an important role to play in this process, through encouraging the needed policies in conjunction with their lending programs, as well as helping to catalyze private bank financing.

Our debt strategy has emphasized the need to reduce both external and domestic imbalances to help lay the basis for longer-term growth. This has required a strong central role for the IMF in the debt strategy. That central role should continue, as a means of encouraging needed policy changes and catalyzing capital flows. In some cases, the use of "enhanced surveillance" may provide a sound basis for catalyzing financing in support of good performers. In others, however, formal IMF programs with greater emphasis on supply-side factors should be implemented.

Increased coordination with the World Bank will also be needed, and it is appropriate that the MDBs also now play a stronger role in the enhanced debt strategy.

The World Bank has made a serious effort to spur growth and facilitate adjustment in a difficult economic environment. Loans to major debtor countries account for a significant share of IBRD lending. Fast-disbursing structural and sector adjustment lending have also increased, and the Bank has expanded its co-financing program to stimulate commercial flows that would not otherwise be available.

The IFC with its expanded capital base and the proposed Multilateral Investment Guarantee Agency can play important roles by improving the investment climate in developing countries and acting as catalysts for non-debt private equity flows. We believe the draft MIGA convention which we negotiated meets all our critical objectives and we intend to seek congressional approval for U.S. participation in the FY 87 budget process.

We believe the World Bank, and indeed all MDBs, have considerable scope to build on current programs and resources. There is ample room to expand the World Bank's structural and sector adjustment lending in support of growth-oriented policies, and institutional and sectoral reform. Since some of the most serious debt problems are found in Latin America, special emphasis should also be placed on strengthening the Inter-American Development Bank's policies to enable it to

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be a more effective partner in support of growth-oriented structural reform. Appropriate debtor country performance standards would be a pre-requisite for increased MDB adjustment support.

We believe a serious effort to develop the programs of the World Bank and the IDB could raise their disbursements to principal debtors to an average of $9 billion annually in the period 1986-88, or $27 billion over the three years. This would represent an increase of roughly 50 percent from the current annual level of nearly $6 billion.

Given the importance of increasing commercial bank flows to the principal debtors, efforts to expand the World Bank's co-financing operations should be pursued vigorously to help borrowers attract private finance.

(3) Action by Commercial Banks

If creditor governments are to be called on to support increases in MDB lending, and if recipient nations are asked to adopt sound economic policies for growth, then there must also be a corresponding commitment by the banking community to help support the principal debtor countries as they make the transition to stronger, sustained growth.

The commercial banks have rescheduled and rolled over nearly $200 billion in developing nations' debt since 1982. Net new bank lending to the principal debtor nations, however, has declined from about $25 billion in 1982 to only $4 billion in 1984.

This reluctance to participate in new money and debt rescheduling packages has introduced serious uncertainties for borrowers, in some cases making it more difficult for them to pursue economic reforms. Pledges of additional financing to support growth oriented policies are an essential part of a comprehensive growth program.

Our assessment of the commitment required by the banks to principal troubled debtors would be net new lending in the range of $20 billion for the next three years. In addition, countries now receiving adequate financing from commercial banks on a voluntary basis should continue to do so, provided that they maintain sound policies.

We would like to see the banking community pledge publicly to provide these amounts of new lending on the condition that the debtor countries also make similar growth-oriented policy commitments as their part of the cooperative effort.

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If developing countries implement growth-oriented reform; if commercial banks provide adequate increases in net new lending to good performers; and if increased demand for quality IBRD lending demonstrates the need for increased World Bank capital resources, we would be prepared to look seriously at the timing and scope of a general capital increase.

Reaction to U.S. Proposal to Strengthen the Debt Strategy

It is clear that there are no easy solutions to the debt problem, and that the road ahead will be difficult and challenging.

The reaction to our proposal to strengthen the debt strategy has been positive and encouraging. Obviously, a proposal of this scope and magnitude will require further careful consideration by all interested parties. Nevertheless, I believe there is broad agreement -- among the industrial countries, the debtor countries, the international financial institutions, and the commercial banking community -- as to soundness of the U.S. approach. There is also a confluence of interest among the interested parties to accept their responsibilities and to work to put in place a workable program which will ease the financial constraints of the debtor countries while encouraging sustainable long-term economic growth.

Since we made our proposal in Seoul, Chairman Volcker and I have held consultations with senior officials of most of the major U.S. banks which have outstanding loans to the principal debtor nations. The U.S. banking community generally recognizes its interest and responsibility in supporting sustained growth in these nations. I am confident that it will do its part by significantly increasing net new lending. The precise mechanisms for doing so should be developed by the banks themselves, and I am sure there are a number of possibilites which they will be exploring. I would emphasize, however, that it is essential that banks from other countries -- who have an equally strong interest in these nations -- also participate in this exercise, and that their governments encourage similar efforts on their part.

Each of the principal debtor nations, in our view, should begin to consider comprehensive policy packages, which would be developed on a case-by-case basis with the support of the international financial institutions. I expect we will have further discussions with the IMF, the World Bank, and with some of the key countries involved regarding the possible nature of such programs and their willingness to move in this direction. Each country's program, of course, will need to reflect its individual needs and circumstances.

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We are hopeful that the U.S. proposal provides renewed impetus for easing the debt problem, and we intend to continue working with all parties to help improve the climate for growth and stability in the world economy.

II. The Poorest Countries

Our efforts to strengthen the debt strategy have focussed on the principal debtors which have access to borrowing in the private markets. However, as your Subcommittee report stressed, there is another group of countries -- the very low-income developing nations, primarily in Sub-Saharan Africa -- which face severe economic difficulties and protracted balance of payments problems and are more dependent on official financing flows. Special efforts are being made to assist these countries, but more should be done to improve their longer-term prospects.

The United States believes that the $2.7 billion available from IMF Trust Fund reflows through 1991 present us with a unique opportunity to use IMF resources to provide a new significant stimulus for growth in the poorest countries.

We therefore proposed a new Trust Fund program using the reflows to provide concessional financing for these countries in support of comprehensive economic programs. The programs themselves would be designed to support growth-oriented adjustment through the adoption of sound macro-economic policies and by removing structural impediments to produce, save, and invest. This would require close Bank/Fund cooperation in the development and implementation of the program.

Other participants in the Seoul meeting clearly shared the United States desire to accord priority attention to the difficulties of the low-income countries. Consequently, the Interim Committee endorsed the U.S. view that Trust Fund reflows should be used to provide balance of payments support for low-income countries implementing programs promoting structural adjustment and growth. There was also a consensus on the importance of the Fund working in close collaboration with the World Bank.

However, the United States is prepared to consider a bolder approach, to encompass joint IMF and World Bank programs and financing to foster adjustment and catalyze additional sources of financing for these poorest countries. I noted that we were prepared to consider seeking resources in support of such a well-coordinated approach if other donors were also prepared to make equitable contributions.

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However, a number of countries are concerned about the concept of joint Fund/Bank operations. Nevertheless, it is our assessment that such joint programs would be a major, practical step in ensuring consistent policy advice and coordinated financial support. We continue to believe that this approach has considerable merit.

We will be pursuing this idea in the weeks ahead. As understanding of the proposal increases, I believe that others will recognize that their initial concerns were unfounded and that this approach constitutes a realistic and effective means of addressing the problems of the poorest countries. We would hope for final agreement along these lines by the end of the year.

The International Development Association (IDA) is also of major importance to the poorest and least creditworthy countries. At a Special Meeting of IDA Deputies in Seoul, the United States and more than thirty other IDA donors agreed to continue working on an operational framework intended to increase the effectiveness of IDA lending. There was also agreement to begin negotiations on an eighth replenishment of IDA to fund operations in the period after July 1, 1987. The Administration will be consulting closely with the Congress on these important negotiations.

Conclusion

In summary, the Seoul meetings reinforced the international community's commitment to further action on the part of both developed and developing countries to promote sustained economic growth, to maintain necessary flows of capital, and to preserve and expand open markets.

The approaches recommended by the United States in Seoul have broad support and form a solid basis from which the international community will be able to respond positively to the difficult and complex debt problems we are likely to face over the next few years.

From this perspective, the Seoul meetings represented a timely and successful exercise of U.S. leadership in the international economic arena.

Mr. Chairman, I believe the proposals we made in Seoul accord well with a number of the key suggestions and ideas in your Subcommittee's report. The report and the series of hearings by your Subcommittee over the last seven months have made a notable contribution to fulfilling our common responsibilities. With an appreciation of your efforts, I look forward to our discussion today and to working closely with you in the weeks and months ahead on this Program for Sustained Growth. Thank you.

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Chairman ST GERMAIN. Thank you, Mr. Secretary.

Mr. Secretary, in your speech to the IMF and World Bank and in your testimony today, there is one point you don't address and I am wondering if we could perhaps look at it for a moment.

If one looks at this plan, this broad panorama, it appears to me that—as I said in my opening statement, that it is inevitable that you are going to have to come before us and ask for additional authorization, appropriations, or contributions to the regional bank, development banks, or to the World Bank, if not as well to the IMF. Am I incorrect in that assumption?

Secretary BAKER. Our plan supposes, Mr. Chairman, that if all of the elements fall into place; if the debtor countries do what we think is required by way of adopting policies for growth; if private banks indicate that they are willing to increase their net new lending; and if the World Bank can move toward using some underutilized capacity that it has now and moves, frankly, toward more structural adjustment type lending; then, and in that event only, we would be up here requesting a general capital increase for the World Bank. But only if the package comes together. I think we made that very clear in Seoul.

Chairman ST GERMAIN. If it would all come together and if all the ifs become realities, do you have any idea what the amount would be?

Secretary BAKER. No, sir.

Chairman ST GERMAIN. You haven't projected that as yet?

Secretary BAKER. We have not done that as yet; no, sir.

Chairman ST GERMAIN. If it occurs, the inevitability is there that we will be called upon to twist some arms for some additional contributions to the World Bank, if not to the IMF.

Secretary BAKER. If those things come together and if the plan works as we hope it will, then we would be pleased to be before you asking for a general capital increase, but we are not at that point yet and we don't think one is needed as of now.

Chairman ST GERMAIN. Now, in my opening statement, I referred to a $20 billion increase, or additional lending over the next 2 or 3 years being sought by the major commercial banks. I ask now, have they requested anything in return? Have they been negotiating or asking for guarantees were they to commit themselves?

Secretary BAKER. No, Mr. Chairman, they haven't. And obviously some banks are going to be more interested, ready, and willing to participate than are others.

Chairman ST GERMAIN. Can you tell us whether or not they can look for guarantees or if they look for little instances in acting on their present loans that none of that is going to occur? Are we in fact going to stand firm?

Secretary BAKER. I can tell you, Mr. Chairman, that there is no armtwisting here; there is no suggestion that there are Government guarantees behind this. We made that clear. I have had two meetings with U.S. banks along with Chairman Volcker, and I think we made it crystal clear we are not talking about Federal guarantees here. If the banks are going to participate, they are going to participate because they find it in their self-interest to do

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so. And because if all of the elements of this package come together, everybody will be better off.

Chairman ST GERMAIN. So what you are telling us—let me make sure I understand you properly and correctly—is that if—you know, it is possible that they might 2 days from now, a week from now, ask for some guarantees that might be helpful or a little talk with the regulators on the accounting and the way they are carrying these loans that are nonperforming loans, that that would be resisted.

Secretary BAKER. Mr. Chairman, clearly, I think it would be inappropriate for us to say that we would not even consult with the regulators. If the banks said in order to make this work in terms of our committing to new increased lending, we will need to have some provision looked at, I think it would be inappropriate for us to say we won't consider that or look at it.

Chairman ST GERMAIN. I hope it would be appropriate for you to consult the banking committees in the House and Senate on this as well.

Secretary BAKER. Yes, sir, it would be.

Chairman ST GERMAIN. Let me ask you this question so we can get to the other members. It sounds to me that you seem to be progressing well in this area.

I am wondering if Treasury and the Federal Reserve Board could do the same thing as far as the farm communities in this Nation are concerned and the innercity communities? I am told they are about $10 billion short, the Farm Credit Administration. They are pretty productive people. Do you think we could jawbone with the banks to help out on the farm crisis as well? Even though I don't have any farms in Rhode Island, you realize.

Secretary BAKER. I met last Thursday with the Farm Credit Administration Governor, with the regulator of the farm credit system, and we have been discussing this issue—the administration has offered to support legislation that would solve the organization and legal problems of the farm credit situation. We have started the process with them.

I might point out the increased new lending we are talking about for the principal debtor countries here is a 2½- to 3-percent increase lending annually over the 3-year period.

The rate of increase is about the same as for lending to the agricultural sector in 1984, which was a 3.1-percent increase. So it is not out of line in terms of the net new lending that is actually taking place in the agricultural sector. We are addressing the concerns and problems of the farm credit system.

Chairman ST GERMAIN. Mr. Secretary, just let me make one observation. In 1977, the Subcommittee on Finance Institutions held hearings on international banking operations, and one of the things we concentrated on was loans to lesser developed countries. Now, we had the big cheese from our three largest banks, telling us how wonderful it was. We had Treasury up here, a battery of secretaries and assistant secretaries telling us no problem, no problem, and look what happened.

That is why I say we will have to look at this very, very carefully. There are a lot of members on this committee, I am sure you

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are aware, who are very concerned about the farm credit situation as well.

Secretary BAKER. Can I volunteer a comment in response to that, Mr. Chairman? I hope everybody understands I am not up here saying no problems. I am up here saying there is a problem and it is a big problem and we ought to address it.

Now, I think this proposal to address it has merit. It only has merit if all three legs of the stool come together. It only has merit if we implement it. It isn't going to be easy to implement. We don't underestimate the magnitude of the task involved.

Chairman ST GERMAIN. Thank you, Mr. Secretary.

We will call on a fellow Texan, of yours that is, Mr. Gonzalez.

Mr. GONZALEZ. Thank you.

The Secretary just reminded me he has a little spread about some 50 miles away from my district, so we are almost neighbors. Lyndon Johnson was exactly that far distance from my district, too.

Secretary BAKER. The other direction.

Mr. GONZALEZ. Both ways. But welcome to the committee, Mr. Secretary.

You suggest that the debtor nations should reduce budget deficits and employ, and I quote your statement, "supply side actions to mobilize domestic savings." Well here in the U.S. supply side policies have quadrupled the deficit, and the rate of personal savings has actually declined by a full 1 percent from what was already a dismally low level of about 6 percent back in 1980.

The rate of economic growth is only about half of what was promised by the miracle supply siders in 1981. In light of what has happened to your own budget and of what the result has been here in the United States, do you seriously think anyone else would follow your recommendations? Might they not think you are asking them to walk the plank?

Secretary BAKER. No, Congressman Gonzalez, I don't. I think if they could have the same results that we have seen in this country over the course of the past 34 months they would scramble to take us up on our offer. We are in the 34th month of economic expansion, the longest since the Korean war. We have more Americans working today than we ever have before in our history and I think there is a lot of our economic program that these countries would be eager to follow.

In fact, it was amazing to me in Seoul that we had the kind of reception that we did have, not just from the other industrialized countries, but the lesser developed countries as well with respect to the embrace, if you will, of growth-oriented policies.

We are really talking about other things than just savings. These countries in order to be competitive and in order to earn the foreign exchange that is going to be necessary to work their way out of debt really should open themselves up to investment. They should privatize their economies to a greater extent since many of their economic institutions are state owned. I think there was a healthy acceptance of that generally in Seoul.

Mr. GONZALEZ. Be that as it might, and of course I can't argue against the apologies for the administration, but the facts do, and so does the reality that we face.

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Obviously greater economic growth is the absolute essential toward anyone making progress on the debt problem.

This has to mean for developing nations expanded international trade. But the world is in a period of emerging trade warfare which is as likely to diminish trade as anything else. This breakdown of international order can be dated back to the Nixon issue that closed down the gold window thereby closing the Bretton Woods Program, which required the kind of domestic policy you advocate at least for other countries today.

It also required adjustments in external relations so trade would not only expand but countries would not be faced with the kind of horrendous trade deficit and conflicts we have today. You are saying that all this disorder needn't be dealt with directly, but those who cheered at the collapse of Bretton Woods and I remember that because I was on the committee when it happened, and its fixed exchange relationships claim trade would become self-adjusted. It didn't.

The United States is example No. 1. Our trade hasn't been balanced in the long run. It has become the most imbalanced in the world. Japan's trade hasn't become balanced and much less has the trade of Latin American countries. The fact is, we don't have a self-adjusting trade system. We have a problem that will not just go away.

Yet the administration is still trying to substitute exhortation for the work of building an international trade framework that really will work as a Bretton Woods system did. Surely you do not believe that the debtor nations are going to grow on the fertilizer of supply side sermons. Certainly. I mean, I think the practical, realistic facts are those. I think they have to be addressed. We can't continue to ignore the problem.

I ask unanimous consent I may submit further questions in writing. I am sure the Secretary would like to reply.

Chairman ST GERMAIN. Is there objection? The Chair hears none.

[In response to the request of Congressman Gonzalez, the following information was received from Secretary Baker:]

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Secretary Baker's Answers to Questions
from Henry B. Gonzalez
October 30, 1985

Question #1: You say -- and I agree -- that more loans to debtor countries won't help, as long as money keeps flowing out their back doors in the form of flight capital. You say that a prerequisite to a general capital increase for the World Bank or expanded capacity in the Inter-American Development Bank would be action to stop flight capital. If you were finance minister of, say, Mexico, how would you stop flight capital? What actions would you take?

Answer. It would be presumptuous of me to attempt to second-guess the finance minister of another country. Nevertheless, it is safe to say that the problem of capital flight generally arises from a lack of confidence in a government's policies. In the case of Mexico, the problem is exacerbated by the country's proximity to the large, strong, and confidence-inspiring U.S. economy. It is relatively easy for any well-to-do Mexican to open a bank account in the United States to help offset the adverse effect on his wealth of local economic policies.

A persistent contributor to capital flight is the huge inflation differential between our two countries and this is one of the first problems that needs to be attacked. Other factors that have contributed to capital flight include the fixing interest rates on Mexican government securities to well below market levels, concern over the possibility of lower oil prices, and, most important of all, a public sector deficit that is proving both persistent and pernicious. Many observers believe that reduced government involvement in the economy, along with needed basic structural reforms, would go a long way towards boosting public confidence and reducing capital flight in Mexico.

Question #2: Mexico was suffering immense economic problems even before the earthquake. The losses from that disaster will require hundreds of millions of dollars to repair or replace [buildings] and, on the whole, prospects for Mexico have become distinctly darker -- not just from the earthquake, but from the continued decline in oil prices. Does the Administration intend to offer substantial help, through the Inter-American Development Bank, through bilateral means, or through such devices as paying artificially high prices for Mexican oil that is acquired for the Strategic Petroleum Reserve?

Answer: We are concerned about the deteriorating situation in Mexico and we support increased flows of financial resources to that country from the multilateral development and commercial banks and from the IMF. These flows, of course, must be in support of basic structural adjustments to lay the foundations for sustainable medium-term economic growth.

The United States, for its part, has proposed $500 million in additional CCC credit guarantees in FY 86, bringing the total to $1.1 billion. With respect to oil, the 1985 supplemental appropriations bill provides financing for the purchase of up to

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11 million barrels of crude for the SPR through May 1986 at market prices. The United States has not, cannot, and will not pay inflated prices to fill the SPR.

Question #3: You talk about the need for debtor countries to correct capital flight and other problems before they can expect significant new loans. Yet they need growth more than anything else. What's going to come first? The capital to grow with, or internal changes?

Answer. As I noted in Seoul, capital flight must be reversed if there is to be any prospect of additional fundings -- whether debt or equity. If a country's own citizens have no confidence in a nation's economic system and policy, how can others? If financial flows are forced in the absence of needed reform, it is simply an opportunity for accelerated capital flight and further postponement of needed changes. The relatively minor boost to economic growth that would ensue would be brief. The economy would still need to adjust and this adjustment would then have to be done without the benefit of supporting external financial resources.

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Chairman ST GERMAIN. The Chair calls on Mr. McCollum.

Mr. MCCOLLUM. Thank you.

I applaud the initiatives you put forth to us today and at Seoul. I think they are commonsense type of initiatives you have explained today and have gotten a good response from the countries involved. I am pleased with the private sector growth-oriented portion of this.

It seems to me and also has seemed to me being a Member of the International Trade Subcommittee that is an essentially ingredient in whatever we are doing. There is one thing absent from your testimony and from the discussion I would like your comments on today.

Most of these countries that have the heavy debt we are concerned with most today have been required to pay back an enormous portion of their growth and gross national product. What little bit they have got right now in the last few years, to the banks that currently have this debt.

They are holding it in the form of interest payments and regardless of the restructuring that has gone on and the stretching out, that continues to be the case. Do you anticipate further restructuring to stretch out this more in order to enable them a little breathing room to go along with what actions they may take to restructure their own internal macroeconomic mechanisms and their growth or lack of growth?

Do you anticipate that there might have to be some forgiveness or moratorium on interest payments to some of these countries in the process by the commercial lending institutions in this country?.

Secretary BAKER. No, sir; I don't contemplate that and I think that would be the wrong road for us to start down. Whether or not there would be more liberal rescheduling would be a matter for the private banks and holders of that debt to consider in the context of the overall package.

We contemplate increased World Bank participation, making use of that facility's ability to create and make structural adjustment loans, longer term loans, which could extend for a longer period of time, and that I think would to some degree ease the debt burden.

But I don't think there should be any moratorium; I don't think there should be any capitalization of interest proposals or anything like that because I think that would result in a loss of confidence on the part of the private financial community.

Mr. MCCOLLUM. How do you anticipate getting the incentive quickly back into the countries that are involved for the local money to stay there or to bring it back to the United States or wherever it has gone abroad?

Secretary BAKER. If you take a look at my speech in Seoul, and maybe I touched on this in the summary of my statement, but it is in my written statement as well, I make the point that it is unreasonable to expect banks—even banks that are heavily involved already—to be interested in increased net new lending as long as there is not confidence by the citizens of the particular country involved, sufficient confidence to keep that capital at home.

As long as you have a situation of capital flight occurring in one of those countries it is unreasonable to expect that any lender is

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going to want to extend any additional credit. The first thing that has to be turned around is capital flight.

Mr. MCCOLLUM. Do you think that capital flight would be turned around if these countries make the structural reforms you are suggesting?

Secretary BAKER. If they would take the macroeconomic measures and make the structural reforms needed, they would get their economies on a sound footing, capital flight would cease, and confidence would return.

Mr. MCCOLLUM. You note in your testimony today there is a decline in new commercial lending to developing nations which are performing well, and you note that is particularly disturbing.

Can you give us some specific country examples of where we have actually had a decline in commercial lending to countries that are performing well?

Secretary BAKER. Well, yes, I will get you a couple here. Several come to mind, but I want to be sure I am right on this. Two in Latin America would be Ecuador and Colombia. There are two right there.

Mr. MCCOLLUM. My last comment is really feeding you a bone but Mr. Secretary don't you think if this Congress enacts protectionist legislation we are going to be working against everything you are trying to do.

Secretary BAKER. Absolutely. I think it is important we preserve the world's free trading system. I think that if the United States goes protectionist we lose the world's free trading system. I think it is fundamental.

Mr. MCCOLLUM. Thank you. My time has expired, Mr. Chairman.

Chairman ST GERMAIN. Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

Mr. Secretary, as an Illinois Congressman and, as you know, a farmer's—especially the family farmers in Illinois are in desperate straits. They are broke. They are in despair.

How can the administration justify bailing out these people when we support huge loans to China, who are supporting their state-run farms? How are we going to justify that?

Secretary BAKER. How can we justify bailing out? We are not bailing anybody out here, Congressman.

Mr. ANNUNZIO. We are justifying not bailing out Illinois farmers, who are in such desperate straits. And, at the same time, we are voting money to help the state-run farmers of Communist China.

Secretary BAKER. If I may say so, I am not up here asking for money today, and I may not be back asking for money. If we can't put all the pieces of this package together, you won't see me back up here asking you for money for this.

Mr. ANNUNZIO. Well, you make me feel good when you say that, because I am not going to vote you any money anyway.

Secretary BAKER. Let me suggest one of the best ways to help our farmers, if I might, Congressman, would be to enable them to export more to some of these countries. If these countries don't get back on their feet, they are not going to be able to continue to take our farm products. And we do still export some agricultural products—admittedly, not as much as we would like, or used to.

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Mr. ANNUNZIO. I don't want to disagree with you, but that is not the problem of the small farmers. We do an export business in Illinois to foreign countries. It is just that they are not able to get the kind of money they need to sustain themselves. There are many factors that contributed to the downfall of the American family farmer.

We are talking here about a new bank, a new international bank. We are talking about money taxpayers are spending. It is difficult. You know, when you run for office and go look at these people in the eye, it is very, very difficult to try to sustain your actions and explain it philosophically. There is just no way of doing it.

Thank you, Mr. Chairman.

Chairman ST GERMAIN. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

First, I need to be sure now, you said you weren't asking for any money. Do you want this $300 million mixed credit program or not?

Secretary BAKER. Yes, sir. But I was invited three days ago to come up here and report on my——

Chairman ST GERMAIN. The hearing is on the Seoul, Korea meeting.

Mr. NEAL. Wasn't that part of your——

Secretary BAKER. No, sir, it wasn't. But I would be glad to try to answer your question about mixed credits.

When I say I am not up here to seek new funding, I mean our new approach to the international debt strategy does not contemplate additional Federal funding. We may come to you for a general capital increase for the World Bank down the line later on. The timing and scope of that, we will consider, if we can put all the pieces of this together. We are not up here asking for money.

Mr. NEAL. I understand you do want the mixed credit program?

Secretary BAKER. Yes, sir, we do.

Mr. NEAL. Let me go to another question, if I may. I am trying to understand your plan. It sounds great. I mean, all the words are right. You want growth and balance and austerity, and so on.

Help me understand a little bit better by using Mexico as an example. What will we be doing differently with Mexico?

Let me give you a couple of specific questions. I haven't been down there in a long time, but I spent a lot of time down there 20-some years ago. At that time, poor people didn't have anything, so they weren't paying any taxes. Rich people didn't pay any taxes. They found ways to avoid paying taxes. So, unless they have changed dramatically, I don't see how you are going to lower taxes.

As for government ownership, and means of production, as you know, the government owns the peanut oil monopoly down there. I thought it would be a great idea for Mexico to sell that off and help pay off some of their debt. But they seem, as I understand it, for reasons of national pride and so on, not to think that that is possible.

So, what would happen to Mexico? Let's say Mexico doesn't attempt to pursue the agreements it has made under the IMF programs. Let's say that maybe they are collecting more taxes than I think they are. But let's say that they are not—or maybe you can

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answer that question—and let's say it simply won't work for them to sell some of their other government entities—peanuts, as I understand, being by far the largest.

What is going to be different? What are we going to do differently than we are doing now in Mexico, which is one of the big debtors?

Secretary BAKER. Congressman, you cited the toughest example in the case of Mexico, and that is having them sell their minerals. They are not going to open themselves up to direct foreign investment to that extent, I am quite sure. But there are a lot of steps inbetween where they are now, and inviting our developers in with respect to their minerals. There are a lot of institutions in Mexico that are still state-owned.

They are in the process, quite frankly, now of selling off some of their hotels. I think some of their resort developments are still state-owned. Cancun is still state-owned. The last time I visited with the Finance Minister from Mexico, he told me they were in the process of selling those hotels down there. Those are the kinds of things—there are a lot of things like that they can do.

They can privatize. They can eliminate a lot of the rigidities in some of their laws. And they can adopt a more progrowth approach to the economy.

Mr. NEAL. In what way? Give me a specific example. They don't own all of the hotels in Cancun.

Secretary BAKER. They still have some trade restrictions. Liberalizing trade, privatization and welcoming foreign and direct investment would be three of the things.

Mr. NEAL. Let's say they don't do it. They have not indicated they are willing to do that. And they are not, by the way, living up to the IMF agreements, even though I know they have tried.

Chairman ST GERMAIN. Would the gentleman yield? I would like to add one factor.

Mr. NEAL. Sure.

Chairman ST GERMAIN. It seems to me I just read recently where many of the wealthy people from Mexico—and we heard this as a result of the earthquake—a lot of the wealthy people have left Mexico and are living in the United States of America, and came in with their money. So to say they should invest in Mexico won't work very well as an example there.

Secretary BAKER. What I am suggesting, Mr. Chairman, is that they permit foreign investment. But the first thing they got to do is stem capital flight. They have got to restore confidence in the economy to the point where they stem capital flight. They have let IBM come in there. I think there are some things they can do.

You say what happens if they don't adopt any of these measures? If I was a director of one of the banks that might be interested in increasing my lending over the next 3 years so I can get my nut back on the bad paper that I got out there, I would say no new policies, no new money.

Mr. NEAL. I know, but you are suggesting that they be encouraged—I am trying to understand you—that you are going to encourage them to not do what they agreed to do under their IMF arrangement; is that correct? You are going to ask them to contin-

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ue that, and you are also going to give them some development money. Is that——

Secretary BAKER. Well, it would be structural adjustment money, long-term money that would be both—hopefully, both World Bank money and private commercial bank money under a cofinancing arrangement that would permit them to take the adjustment measures necessary. But they would have to commit to do this before any new money would be forthcoming.

I think my speech made that very clear. I said first and foremost the principal debtor countries have to be willing to undertake these reforms. If they are not, there should be no new money.

Mr. NEAL. My time has expired. Thank you, sir.

Chairman ST GERMAIN. Time well spent.

Mr. Grotberg.

Mr. GROTBERG. Thank you, Mr. Secretary.

The list of stock questions we have before us does not include my question, so I will try to ask it briefly and directly.

There are those of us who believe that if something isn't done, about 10 years down the line the Japanese chairman of the World Bank will be sitting here telling America to get its act in shape or they will cut off loans. It is a worst case scenario, but we know that as we hammer on developing and lesser developed nations to make structural reforms, and we don't structurally reform ourselves, we will be among them.

I would only ask—and you know, and everybody in this room knows what I am talking about—in your mind's eye, where is America in this structural reform, Mr. Secretary?

Secretary BAKER. I think there are certain things all of the major industrial countries should do, Congressman. And we made that clear in writing at our meeting at the Plaza Hotel in late September when we addressed the question of the strong dollar. And one of the things we said the United States must do is get a handle on its fiscal deficit. We should implement fully the budget resolution.

In my own view, we should implement the Gramm-Rudman amendment to the debt limit bill which is now in conference. I think that would be structural reform——

Mr. GROTBERG. Would that be perceived well worldwide?

Secretary BAKER. I think it would. I think it would be well-received, and I think it would say to the world that we are grappling with our fiscal deficit.

Mr. GROTBERG. Assuming that your conference is like all other conferences, you have a little, quiet boiler room time with your peers around the world, and not all of it is open to the public. What are the world financial leaders saying about America in the quiet moments?

Secretary BAKER. I tell you, they are saying several things. They welcome America's willingness to lead in economic matters. America is the largest economy in the world, and America should lead, and they welcome that.

They are also saying that America ought to get a handle on its fiscal deficit. That is, in fact, incorporated in our statement in the Plaza Hotel in New York meeting in late September. It is a commitment we have undertaken.

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I think Gramm-Rudman is a step in that direction.

Mr. GROTBERG. Thank you. My time has expired.

Chairman ST GERMAIN. Mr. Schumer.

Mr. SCHUMER. Thank you, Mr. Chairman.

I welcome the Secretary here and welcome his leadership. But I have real doubts about the plan the Secretary is putting forward.

The basic doubt I have is that it seems to me that it is more of the same, stay the course. We have been talking about the banks putting more money and more money and more money to solve this problem for 5 years. We have been talking about austerity for a very, very long time. And every time we talk about it, we say we will see a change after 2 or 3 years and the only change we see is a change for the worse.

What we did in New York City is the same thing you are recommending be done here, which is to keep throwing more and more and more money into the pot. This creates greater burdens on the banks. They don't want to put the money in, and with good reason. It doesn't solve the Third World debt problem, because it means that their interest burden grows as the principal grows, and requires an austerity that is counterproductive not only from their point of view, but also from that of the United States as an exporting nation—and more than 20 percent of our trade deficit which has everything to do with Latin America; but nothing to do with Japan or Western Europe. All to no end.

So I would like to ask the Secretary, instead of asking for $20 billion of new money from banks already toppling over from this, why not take the existing amount of debt that they have and encourage lenders to stretch out that debt and charge a lower interest rate? That won't topple the banks. It may mean they will have less profit than they did before, but it is their stability we worry about here on this committee—and solve the problem that way.

It gives the Third World countries room to grow. It doesn't throw good money after bad, and at the same time it accomplishes the same result. That is when you will see the light at the end of the tunnel.

Mr. Secretary, you are a man I greatly respect but I think you are treading on a road that has proven to lead to nowhere.

Secretary BAKER. Let me respond to that this way, if I might. I don't think we are treading the same path. I would agree with you that this is an approach that builds on our case-by-case strategy because you have to consider each country individually. But you said we keep pouring more money and more money.

That is really not what we are saying here. You say more money, without getting the fundamental reform. Here, for the first time, we are saying no reform, no money.

I would agree with you in the past that the banks have continued to come up with money without looking at the consequences of long-term structural reform. That is one fundamental difference.

I also disagree with you, if I might respectfully, sir, where you say that if you just stretch this out and reduce the interest burden, you will give these countries room to grow. They cannot grow without capital flows. Capital flows are going to come in one of two ways—either they are going to come through direct investment, which would be ideal if we could do it—those are the kinds of cap-

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ital flows we want to stimulate with economic policy changes—or they are going to come in the form of debt. Without some new capital flows, those economies can't grow.

Mr. SCHUMER. I would ask, Mr. Secretary—every time we try austerity, we run into the other wall. You say no money without austerity. That is just what the IMF and your predecessor, Secretary Regan, talked about as well.

What happened—if I just might finish—what happened is, we saw such instability in so many of these countries that you finally got a man like President Garcia, of Peru, saying, "I am only going to pay a certain amount now, so I can have the room to grow."

The second point I would make is this $20 billion the banks are going to put in, that is not going to be used for growth. We know what that is going to be used for. That is going to be used to pay interest on the existing debt. That doesn't help these countries a lot.

Secretary BAKER. I would disagree with the latter statement. When combined with additional World Bank funding, I think it is going to be used for growth.

Let me say this: We are not saying more austerity, more austerity. That is another difference, if I may say so, in this approach. That is not what we are talking about.

It doesn't require austerity to open your country to foreign investment. It doesn't require austerity to sell your state's centrally-owned assets. It takes some political will, but it doesn't require austerity.

Mr. SCHUMER. Is there a requirement in this plan that this new $20 billion be used for investment and capital, and not to repay interest?

Secretary BAKER. No, sir.

Chairman ST GERMAIN. Excuse me.

Chuck, we have got a lot of Members upset with me on time. I say to the Members that the Chair is attempting, as he has in the past, to call upon them in the order that they arrived, because I thought we all agreed a long time ago that seniority isn't the way to go, unless it is within 5 or 10 minutes. I am trying to be as fair as I can with everybody on both sides of the aisle. That is why you noticed I went to Mr. Grotberg.

Now I call on Mr. LaFalce.

Mr. LAFALCE. Thank you, Mr. Chairman.

Mr. Secretary, it is a pleasure for me to see you before the Banking Committee. I am glad you are here.

If it is our fault that you have not been here before now, we have been remiss. The Banking Committee has issues that are as important as tax reform, although they are both very important.

Second, let me make a point with respect to your response to Mr. Annunzio about the failure of the administration to respond to the farm crisis in the United States, while responding to the state-owned farms in China where you said, "But we are not asking for any money," I think that response is a little bit disingenuous because it seems to me that your hope is that the pieces to the puzzle will fall together that will enable you to come before this committee to ask for money. So if you had your way, you would be coming

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before this committee and then you would have to face up to the apparent dilemma proposed by Mr. Annunzio.

On another point, a good many Members have praised you for your bold initiative. I think the word "bold" is a poor description. I would praise you tremendously for the effort that you are making. I would praise you tremendously for the great change—and I think it is a great change—that you have brought about in administration policy with respect to the problem of Third World debt.

I wouldn't go as far as Robert Samuelson did in Newsweek in referring to your plan as a wet noodle. It seems that somewhere between a wet noodle and bold new initiative, we might have reality.

The problem that I see with your plan is that it is not specific enough. It seems to me it doesn't offer enough to get genuine reform from the debtors or enough to get a commitment from the banks or even enough promises, and lending. In other words, as a start in changing policy of this administration, your plan has merit, but it just seems to be not bold enough and not specific enough.

Secretary BAKER. Well, Congressman, I think—I suppose my answer to that would be that you have to crawl before you walk, and walk before you run. We are going to take it one step at a time.

I quite agree with you there are some implementation steps that I think—if you read my speech in Seoul—we indicated that we had to address and we have to work out. We accept that. But you have to have a concept and a plan and a proposal to get things started.

Mr. LAFALCE. Let's crawl, walk and then run together. But I think we have to run soon before the problem runs away from us.

One followup, clarification question. In your written testimony, you said the three "ifs"—if developing countries implement growth-oriented policies; if multilateral institutions become more effective; if commercial banks lend more, we could solve the debt problem. But in your verbal statement, you didn't say there would have to be implementation. You didn't say there would have to be a provision of money. You said if they committed to growth oriented reform, even though they hadn't implemented, if the commercial banks indicated a willingness to give adequate increases, then you might come forth in support of a general capital increase.

Which is more accurate? Your verbal presentation or your written?

Secretary BAKER. I would rather rest on the written.

Mr. LAFALCE. I would hope your verbal is. If you put the pieces of the puzzle——

Chairman ST GERMAIN. If the gentleman would suspend, the Secretary will suspend—this won't cut into your time—I am going to ask the delegate from the District of Columbia, Mr. Fauntroy, to take over the Chair.

At the conclusion of Mr. LaFalce's 5 minutes, Mr. Lundine is up next, I believe; Mr. Schumer, Mr. LaFalce, then it is Mr. McMillan. By then, the chairman will have returned.

Mr. LaFalce.

Mr. LAFALCE. Please continue, Mr. Secretary.

Secretary BAKER. Staff tells me that the reading copy did not differ from the written, Congressman.

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Mr. LAFALCE. I am not talking about the reading copy. I am talking about your verbal testimony. I am talking in response to questions.

You said if there is an indication of an interest on the part of the banks and on the part of these countries then you would come forward. Are they going to have to go first, or are we going to be marching lockstep with them?

Secretary BAKER. What? In terms of a GCI?

Mr. LAFALCE. Yes; how are we going to be able to get them to commit, unless you do come in.

Secretary BAKER. I would respectfully disagree with that. I agree with some of your earlier comments. I think the worst thing we can do would be to come up here and ask you for a general capital increase until we saw substantial progress—let me put it that way to you—on all three goals. Because if we don't have that, they will put that GCI in their pocket and walk out, and that will be the end of it.

Mr. LAFALCE. If this administration had a different track record, you could take that approach. Given the past track record, I think you are going to have to show the bold initiative.

Secretary BAKER. So far the acceptance has been very good, not only from the debtor countries but as well from the banks, particularly those heavily involved, obviously. So perhaps we can make it work this way.

I really believe tactically it would be a mistake to lay Federal money on the table, assuming you would give it to us. And I am not sure that is an assumption that is reasonable to make.

Mr. FAUNTROY [presiding]. The time of the gentleman has expired.

Secretary Baker will notice that though all of my colleagues have gone to vote, and that I am still here. That is because while I represent more people, more taxpayers, than any single Member of the House, and while I represent more people than 14 Senators—because there are 7 States that have less people than we in the District of Columbia—I and my constituents are known among Americans to endure the tyranny of taxation without representation.

I couldn't resist informing you of that as you wonder why the fifth ranking member of the committee would suddenly assume the Chair, and continuing the questioning that we are here to share with you.

I now yield to the gentleman from North Carolina, Mr. McMillan.

Mr. MCMILLAN. I like this new batting order that we are following today. I see that we have got an intervening vote.

Mr. Secretary, I just wanted to welcome you, as well. I want to just probe a little bit further the $20 billion in the prospects for securing those commitments.

Could you for the committee put that in the perspective of the aggregate indebtedness that exists among so-called problem countries today? In other words, what does $20 billion really mean in terms of the aggregate indebtedness of those nations?

Secretary BAKER. $20 billion, Mr. McMillan, is about 2½ percent per annum increase in the outstanding claims owed by 15 countries to the private banking institutions of the world.

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Mr. McMILLAN. In terms of the counter commitments we are seeking on $20 billion, are we including other banking institutions in the free world—the Japanese, West Europeans?

Secretary BAKER. Yes, sir; not just U.S. banks.

Mr. McMILLAN. Good.

Now, in terms of monitoring the success we are meeting in securing commitments, is there a formalized procedure set up so that we, as the leader in this endeavor, can keep the books, so to speak, on the progress we are making?

Secretary BAKER. No, there is not, Mr. McMillan. And that is one of the matters we have been discussing in depth with the U.S. banks.

As I said earlier, we have had three meetings with the principal U.S. lenders, and the mechanism for doing that is something that we have been discussing. Heretofore, that has been handled ad hoc country by country with a number of different syndicates composed of a large number of banks. We are exploring the possibility of finding a more convenient way administratively to do that. But it would not be a Federal institution. There would be no Federal arm-twisting or Federal mandation of anything; purely voluntary on the part of the banks.

Mr. McMILLAN. I thank you very much.

Mr. FAUNTROY. Mr. Secretary, while I do not have a vote on the floor, I do have a vote in committee, and I do enjoy the privilege of seniority.

In my capacity as Chair of the Subcommittee on Domestic Monetary Policy, it was my privilege to travel to Seoul and to be with you there when you outlined this new approach to the international debt crisis. I have two questions in connection with that approach.

First, in my discussions with some of the Ministers of Finance from the developing nations, particularly those in Africa, are pleased with your suggestion the $2.7 billion trust fund in the IMF be committed to the poor nations of Africa. However, I found it difficult to answer a question from some of these Ministers of Finance that had to do with where this net new lending that you suggest would come forth from—how can commercial banks lend these nations some $20 billion. What is the source of your optimism with respect to that?

Secretary BAKER. The source of my optimism, Mr. Chairman, is that simply it is going to be in the self-interest of these banks to do this. If it is not in their self-interest, they won't do it. They have got some loans that are in trouble, and it is like any other—at least the way I view it, it is like any other workout situation. If there are ways to treat the problem overall, a broad-gauged approach to it, it is very possible additional new flows would make a bad loan a good loan.

Now, if they come to the conclusion that is not the case, it won't be there. I think they will conclude that it is the case. But only if we get the actions that are required from the principal debtor nations, and only, frankly, I think, if we get additional participation from the World Bank. I am not talking about guarantees; I am talking about cofinancing type situations. Although, the World Bank has a guarantee capacity that could be used sporadically.

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Mr. FAUNTROY. There was also discussion at Seoul of an insurance plan for investments. Would you care to suggest to us what role that might have?

Secretary BAKER. Are you talking about the MIGA?

Mr. FAUNTROY. Yes.

Secretary BAKER. That would be the agency, multilateral in scope, that would simply guarantee investments in lesser developed countries. It would be a public and multilateral form of OPIC, the Overseas Private Investment Corporation, which our Government—a quasi-governmental operation which functions for investments by U.S. companies, insuring political risks, insuring expropriation, that sort of thing.

Mr. FAUNTROY. What prospects are there that MIGA will ever become a living reality?

Secretary BAKER. I think there is an excellent chance. It is well supported by most of the industrial countries. I think it will come to be accepted more and more by the LEC's. If we are going to ultimately open the world to investment, if we are going to have the kind of private capital flows into these countries that I think they desperately need, an institution like this will help make that happen.

Mr. FAUNTROY. Can you suggest to us what might be the increase in interest payments as a result of this new structure?

Secretary BAKER. Increase in interest payments to whom or by whom?

Mr. FAUNTROY. To debtors by those who hold their debt.

Secretary BAKER. Increase from debtors to creditors?

Mr. FAUNTROY. To creditors, yes.

Secretary BAKER. No, I really can't, because I don't know at what rates this new money, should it be made available, will be put out. Hopefully, the banks would see fit to loan on the most lenient terms possible since we are talking about workout type loans.

Mr. FAUNTROY. Mr. Secretary, for the three-quarters of a million people whom I represent in the Congress, I voted with my colleagues in the committee, as did my colleagues on the Foreign Operations Subcommittee on Appropriations, to provide $75 million over the next 3 years to the sub-Saharan African facility of the Bank because of the legitimate concern that millions of Americans have demonstrated of the plight of those suffering from famine and other disorders in sub-Saharan Africa. Those with whom I talked in Seoul found it difficult to understand, as I do, why the administration has taken the position it would not welcome that appropriation, even though in the considered judgment in this committee and the Foreign Operations Subcommittee believe we need to do this humane lending—we ought to commit $225 million over the next 3 years to the sub-Saharan facility. Would you care to explain to the committee why you oppose that contribution.

Secretary BAKER. I think it is primarily a function of the fact the United States last year alone contributed $1.7 billion to Africa. And so, no one could suggest that we were in any way being stingy in terms of discharging our duty to the problems of that continent. I think the United States was far and away the largest contributor to African countries last year.

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A number of your companions on the committee have talked about the severe budget constraints that we face. It is our view that if the United States is going to contribute $1.7 billion in bilateral assistance, we should not at the same time be making a contribution to the sub-Saharan facility; put simply, we have elected to handle our responsibilities there on a bilateral rather than multilateral basis.

Mr. FAUNTROY. I would simply hope that should the House in its considered judgment, and the Senate in its considered judgment, agree with my vote in committee, that you would in the administration accept the judgment of the Representatives of the people of this country and the Congress.

Mr. Lundine.

Mr. LUNDINE. Thank you, Mr. Chairman.

Mr. Secretary, as has been indicated in a number of questions today, there are some of us who support multilateral development banks, who feel that it is going to be—if this plan comes together, it is going to be necessary for additional funds to be voted by this Congress in terms of a general capital increase, and in other ways that would have budgetary effects.

At the same time, as you briefly dial out with the gentleman from Illinois, the Gramm-Rudman proposal seeks to seriously cut back on spending across the board, do you not think that the atmosphere as far as expenditure, if Gramm-Rudman is passed, would be such that it would be a very difficult, maybe an impossible environment for getting the kind of support to back up this program that you might need?

Secretary BAKER. Mr. Lundine, it has always been difficult. As the chairman also pointed out in his opening statement, I think it was extremely difficult in 1983 when we had the last major vote on this. It is always difficult. Multilateral development institutions do not have a big constituency in this country. But they are very important and perform a very important function in terms of our relationship to these countries and the international economic system generally.

So I share your view that it will be difficult, but I think it would always be difficult. If it is the right thing to do, we ought to try to do it whether it is difficult or not.

Mr. LUNDINE. I think you are to be commended for a fresh, new departure in administration policy. But if we are going to succeed at that and the pieces do come together, we are going to need the active support of President Reagan himself.

Is he committed to this program?

Secretary BAKER. He is certainly committed to our building upon our case-by-case approach to the international debt strategy, yes. We have not made a commitment as an administration yet to seek a general capital increase for the World Bank.

As I indicated to Mr. LaFalce, I think that tactically would be the worst thing we could do if we really want to get this program implemented, because you are not going to get fundamental reforms from the debtor countries and not going to get increased new lending from the banks if the Federal Government steps out in front and puts its money on the table first.

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So, that has not as yet been addressed. But I can certainly tell you that the President supports this approach to the debt strategy, absolutely.

Mr. LUNDINE. That is the final question that I would like to pose. Exactly what is the strategy? I fully agree that we ought not to make it easy or lay that money on the table and say now we hope that the rest of the pieces fall into line. But as you have gathered, there is a little bit of skepticism among some members here on this committee, and I gather you got greeted with a little bit of concern, both by creditor and debtor nations, in meetings in Seoul.

Secretary BAKER. Generally, we were surprised, quite frankly, about the rather broad acceptance it was given.

Go ahead. I am sorry.

Mr. LUNDINE. Actually, I had a staff person—as you know, I could not go over there because of votes here. I had a staff person there, and he verified that, Mr. Secretary. I read the newspapers here, and you wouldn't have known it went over so good from reading the newspapers. Of course, we in public life are not entirely unfamiliar with that.

In any event, what do you see as the next step in selling this program, carrying out this strategy, the next major component?

Secretary BAKER. I have already indicated that we are working actively now with U.S. banks. Our counterparts are approaching their banks. Again, there is no help, no arm-twisting here. This is something the banks are going to do if they deem it in their self-interest. If they don't, they are not. That is step No. 1.

Step No. 2 is to work with the World Bank and the IMF with respect to a major debtor country. This is, after all, building on a case-by-case strategy. The way to prove, I think, that it can work is to find a country and then to have the institutions work with that country, since we are saying first and foremost we have to have policies implemented that can make this strategy possible. So it is not something that is going to be done in the short term.

The case-by-case strategy we have been following has been going on now since 1982. This isn't something that you can just wrap up in a nice, neat, little package and say it is done with respect to all debtors. You have to do it debtor by debtor.

Mr. LUNDINE. My time has expired, but let me say I think the members of our subcommittee unanimously would agree with what the Secretary just said—that the IMF and the World Bank ought to work together with one country and see whether a joint program couldn't be devised.

Chairman ST GERMAIN [presiding]. Ms. Oakar.

Ms. OAKAR. Thank you, Mr. Chairman.

Mr. Secretary, I am delighted you are here, as well. I certainly concur that we ought not to ignore the Third World nations. But let me lay it on the line politically, because I think you are probably the most active and successful political strategist the President has. I don't say that lightly; I really believe that.

The fact of it is, in an earlier question by one of my colleagues on the other side, you kind of glossed over the trade issue, and the fact of it is that just every region of our country is affected by the enormous trade deficit which many of us believe in part is due to

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the overvalued dollar, which I believe personally is because of the administration's policies.

The first budget bill and the tax bill that you have effectively, I think, pushed forward and encouraged Members on both sides of the aisle to support. I was one of them. But, nonetheless, that is what happened. You can't gloss over that because the exports that are impacting on farmers and the textile industry and the steel industry and high tech, this is no longer 9 years ago in my first term. Those of us from steel areas were the only ones talking about the deficit problem and trade deficit relative to our area.

Now, it is no longer a regional issue. This is a national phenomenon the people feel very strongly about. It transcends regions and it transcends the type of materials we are talking about.

So how political—I am talking as someone I respect politically—how can you sell the American people on increasing the leverage that we will give to banks when in fact they perceive they are not being given a ripple of concern about this enormous trade deficit, and indeed in part related to the Reagan deficit in this country? How can you sell this program?

Secretary BAKER. I think what we would have to do is to point out that we are addressing the problem of the strong dollar. Someone mentioned a policy change as far as the administration is concerned. I might argue that is building on the communique from the Williamsburg summit. But whether it is a change of policy or not, we are addressing the strong dollar.

The President has recently delivered a speech with respect to trade measures that he is going to take. He has self-initiated five or six 301 cases, the first time in history I believe any President of the United States has ever done that. He said he is going to take an aggressive posture with respect to enforcing the unfair trade laws of the United States.

Ms. OAKAR. We are glad about that one because, let me tell you, he has not used his authority up until this point. It is a little belated, but if he is going to do that I think that is terrific.

Secretary BAKER. There are a couple of things.

Now, we have before your committee a proposal for a mixed credit war chest of $300 million to fight unfair trade. We have worked very hard with the Japanese to open their markets and to internationalize the yen, and we made a little progress in the yen-dollar talks. I really think we have. So we are addressing the problem in ways that do not to us constitute protectionism.

I can't tell you that it is not a hard sell politically to get money for the multilateral development institutions. I can tell you this: To the extent the world trading system shuts down, and the free trading system of the world shuts down, to the extent we get engaged in protectionist fighting, one of the first interests that is going to suffer is our agricultural interests.

It is important to the international economic system that these debtor countries find a way out of their debt so that they can buy our products.

Ms. OAKAR. Let me just ask you the question that I asked as a conferee of the Gramm-Rudman area. I think Mr. Lundine touched on it.

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How would a Presidential order reducing spending affect the ability of the Treasury to make payments which have been authorized and appropriated, but not expended for the International Monetary Fund, the Inter-American Development Bank, the Asian Development Bank, and the African Development Fund? And you can include with respect to that the portion that is under budget responsibility for the World Bank. How would that be affected?

Then I will tell you what the staff said today, of the Senate. See if there is any unilateral agreement here.

Secretary BAKER. Our General Counsel says those are the equivalent of irrevocable letters of credit and probably would be exempted under the prior contract's exemption they are now talking about for Gramm-Rudman.

I do think there are changes being made, or at least being debated in the conference with respect to Gramm-Rudman. So I don't want that to be a definitive answer.

Ms. OAKAR. Mr. Chairman, I have several other questions in writing I would like to forward to the Secretary.

Chairman ST GERMAIN. Without objection, all members will be given the opportunity to submit further questions in writing.

Mr. Bereuter.

Mr. BEREUTER. Thank you.

Mr. Secretary, I want to in all sincerity congratulate you and commend you and all the people in your Department for the new direction you are attempting to give to the IMF and the World Bank, the collaboration, the parallel conditionality.

Several of my colleagues have made reference to the troubled state of agriculture, which I certainly can provide a great many examples of. But I think it is probably important to reemphasize what you already said, and that is that moving away from the austerity emphasis of the IFC is crucial in that area because agriculture exports from my part of the country have been reduced to Latin America alone by the extent of 20 to 40 percent. And the kind of IFC austerity programs have also brought political turmoil to the Dominican Republic, and violence, and they are pushed up to the wall.

So I think the emphasis on privatization of Latin America, in particular, impediments to foreign investment there are crucial. Those changes are crucial.

In Africa, the counterproductive agricultural policies, it seems to me, are the kinds of examples that we ought to cite.

My questions to you are three brief ones. I noted that you have avoided the phrase "cross conditionality" and talked only about parallel conditionality. But, one, isn't it equally important we try to get our regional MDB's to also work in this kind of fashion, to have this kind of conditionality?

Second, shouldn't we look at some of our own bilateral assistance programs and aid and make sure they are working in collaboration?

Finally, what are your opinions about the World Bank's guarantee authority as a method of increasing coal financing?

Secretary BAKER. The answer to the first two questions, Mr. Bereuter, would be "Yes," with a slight caveat on cross conditionality,

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which is that it is a word of art as far as some of the debtor nations are concerned, and we ought to be careful how we——

Mr. BEREUTER. I think you prefer parallel conditionality?

Secretary BAKER. The answer to those two questions is yes.

The answer to the third question is, there is authority for World Bank guarantees, but I think we ought to be careful so that people don't misunderstand what our proposal is.

We are not suggesting to private banks they come up with additional lending only in the event that they somehow obtain a World Bank guarantee. We are suggesting that they do this—if they look at their hole card and see that it is in their interest to do it.

I think I said earlier, there is room for some World Bank guaranteed loans, but that is not something we think is a foundation or a keystone of this proposal. We would rather talk in terms of cofinancing than guarantees. This is not a bailout proposal.

Mr. BEREUTER. One followup on that.

Would the new World Bank entity have greater similarity to our OPIC organization to deal with those uncertainties relating to international disasters of one kind or another?

Secretary BAKER. The same what?

Mr. BEREUTER. Wouldn't it be more parallel to OPIC?

Secretary BAKER. Yes.

I think I said earlier, the MIGA is an equivalent of OPIC.

Chairman ST GERMAIN. Mr Kleczka.

Mr. KLECZKA. Thank you.

Mr. Secretary, one of the key components of your proposal is a $20 billion increase in commercial bank lending to debtor nations. This comes on the heels of the fact new bank lending has declined from about $25 billion in 1982 to about $4 billion in 1984.

Last Thursday, you met with representatives of 25 U.S. banks with the biggest exposure in loans to less developed countries. What was their response to your suggestion of new loans to major debtors?

Secretary BAKER. For the most part, it was positive, as was the response from a smaller group before we went to Seoul, and as was the response to Chairman Volcker yesterday in New Orleans at the ABA. Some of the smaller banks obviously, I think, would probably just as soon find a way out of the trap instead of look at some new cheese. But I think overall it was a positive response.

Mr. KLECZKA. You indicated the response was positive.

Did you offer or hold out any hope for guarantees on this additional $20 billion?

Secretary BAKER. No.

Mr. KLECZKA. None whatsoever?

Secretary BAKER. No. I just answered Mr. Bereuter's question that the World Bank guaranteed program could be part of this very sparingly, but let me say it one more time. We are not asking the banks to come up with new money based on any promise of a Federal guarantee, World Bank guarantees, or specific regulatory relief. We are asking them to look at this proposal and come up with that additional money if they find it in their self-interest to do so.

Mr. KLECZKA. Let me ask this final question, then.

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Is there a positive response to this proposal any way connected to the recent Ways and Means action giving an additional break to banks relative to their loss reserves, contrary to your proposal to this Congress?

Secretary BAKER. No; I don't think so.

We were very disappointed with the action of Ways and Means. We still support the elimination of the loan loss reserve deduction. We think it is only fair that banks take a deduction for their actual losses, not their assumed losses, particularly when you consider there are a lot of banks out there who have an effective tax rate of 6 percent. So these are two different and independent matters.

Chairman ST GERMAIN. Excuse me.

What percent?

Secretary BAKER. Something like 6 percent. There are some banks that have an effective tax rate of something in the neighborhood of 6 percent.

So I guess what I am saying is, this isn't something we are offering to them. We lost that one in Ways and Means. We would like to see it turned around.

Mr. KLECZKA. You don't think the action of Ways and Means and their positive reception to your plan is in any way connected?

Secretary BAKER. No, I certainly don't. I think these are independent matters. We ought to judge each on its own merits. We are very unhappy with the action of Ways and Means, quite frankly, and would hope to see it reversed.

Chairman ST GERMAIN. Mr. Lehman.

Mr. LEHMAN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. I hope you get the message today in the minds of many members of this committee and this Congress any additional funding of the IMF or any additional loans to foreign countries is politically very closely tied to the farm crisis in this country, and it is going to be very difficult for many of us to vote any more money or ask anybody to do any more when we have farmers here at home who cannot get money for their crops this year or are behind on their payments and are not getting the same type of treatment foreign countries get.

Secretary BAKER. I understand that, but could I just say one more time that the rate of increase in private bank lending that we are asking for here is lower than the annual rate of increase that we saw in 1984 for agricultural sector loans. So, I hope we don't lose sight of that fact. I understand what you are saying.

Mr. LEHMAN. That has to be explained to the farmer who cannot get financing.

Secretary BAKER. I understand that.

Mr. LEHMAN. The problem is you have a farmer who cannot borrow money for his tractor seeing money being loaned to Mexico or Brazil for people to buy tractors there.

Secretary BAKER. I understand. But those people want to export their crops, too.

Mr. LEHMAN. They are very concerned money going abroad is not going into areas expanding any trade for them.

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In many instances, we cannot get products into those countries, and in many instances, the things are in competition with the American farmer.

It is not as cut and dried as you are saying.

I wonder if, in view of the fact that American banks, as Mr. Kleczka has pointed out, are cutting back on their foreign loans dramatically, is it realistic at this point in time to ask them to increase, or put the carrot there for them?

In response to Mr. Schumer's question about whether or not this money would be used to pay interest, you said yes. Is that the carrot?

Secretary BAKER. The carrot is simply that if everything comes together there is a reasonable chance that some of these debtors can work their way out of debt, and the banks can get repaid.

What is the carrot? The banks have an ox in the ditch right now. They got a loan that is under water, and they want to try and work it out.

Now, as I have said before, and I will say one more time, if it is not in their self-interest, they are not going to do it. I think some of them will find that it is in their self-interest. If we can get the policies adopted in these countries that will permit them to repay their debts. There is a further incentive, I suppose.

Within the world bank lending ceiling, underutilized today, there will be increased bank lending to these countries which will help provide capital flows to get these economies going.

That is the carrot.

Mr. LEHMAN. Thank you.

Chairman ST GERMAIN. Mrs. Roukema.

Mrs. ROUKEMA. Thank you very much.

Mr. Secretary, I want to welcome you today. You have been here for more than an hour, and we do appreciate your appearance.

I would like to support your very intelligent approach to the problem. I appreciate the way you are trying to put this package together, so to speak.

I share some of the same skepticism of some of my colleagues as to whether or not it will be a feasible program, whether or not it will fit together or not, but you are certainly going in the right direction.

We shall reserve acknowledgement until we see how those pieces do fit, but I have another facet of the problem to ask you a question on.

You have clearly indicated thus far in the questioning that there are profound economic, social and political consequences to the world debt problem and all the activities of the multilateral development banks.

One of those aspects that has not been touched upon but your reports relates directly to is the world problem of hunger and malnutrition.

As a member of this committee as well as the ranking member on the Select Committee on Hunger, I want to ask you a question.

We have all had dramatized in this last year the terrible endemic problems and the human tragedy in Africa, and we are beginning to see a recovery there in terms of the immediate crisis.

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The crisis continues, but at least it is not being exacerbated. We are now on the brink of the longterm development needs which you have addressed not here today but in your written statement, I believe.

It is unclear to me—on page 12 you refer to the trust fund, and I wondered if you would amplify on the operations of the trust fund as you have proposed it and understand it, and relate it to the structural development needs not only in Africa, but also in Latin America, because that is another aspect of the problem that has not yet been addressed in this hearing today.

Secretary BAKER. Well, let me see if I can answer your question this way.

We agree that the trust fund reflows should be used for the poorest nations. This was a separate proposal from our approach to the debt strategy, where we are talking about principal debtors. Here in the trust fund, we are talking about the poorer countries.

We, in fact, proposed something additional to that when we were at Seoul, but we did not have agreement among all of the G–5 countries to move forward on a more comprehensive proposal.

That is taking the trust fund reflows of $2.7 billion, combining them with some World Bank funding and possibly some additional funding from the industrialized countries, to create a bigger facility that could be used to address the needs of the poorest countries.

It is a proposal that we thought had merit, that we still think has merit, and it is one that we want to continue to explore as we move forward here.

Frankly, we have got to be able to sell it. Again, there is no budgetary impact as far as the United States is concerned. There would be some reprograming involved, for which we would come to you for approval for.

But we think there is a need there, and it ought to be addressed, if that answers your question.

Mrs. ROUKEMA. I am not quite sure. This is an additional infusion or new approach to the IDA—is it related directly to IDA, or is it a separate new approach to the trust fund?

Secretary BAKER. That would be a separate new approach. It would be separate.

Mrs. ROUKEMA. And additional.

Secretary BAKER. It would be in addition.

Mrs. ROUKEMA. All right. I would like to say to you, if you would pursue this project aggressively—I don't know why there was a division, and I know there was a division in Seoul on this subject—if you would pursue it aggressively and relate it directly to problems we have encountered in Africa, and that now it is an attempt to forestall and avoid any future famine catastrophes in the next decade, that I think you will find a good deal of support, because there is an economic self-interest as well as a humanitarian interest, and this could be the basic underpinning of a self-sufficiency program in Africa which, I think, is doable over the next decade or two.

Secretary BAKER. I think we would agree with that.

I might say the other G–5 countries were concerned that there might be a possible blurring of the distinctions between the roles of the fund and the bank if we put this new facility together.

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Mrs. ROUKEMA. Was that a geographic division between countries, Latin America versus Africa?

Secretary BAKER. No, it had to do just with the new facility. Mr. Chairman, may I finish the answer? I am almost finished.

Chairman ST GERMAIN. We have got other members, that is all.

Secretary BAKER. They were also concerned it might have an adverse impact on the sub-Saharan facility, and quite frankly, a lot of them have contributed to the sub-Saharan facility.

We have done ours bilaterally.

Mrs. ROUKEMA. Thank you very much.

Chairman ST GERMAIN. Mr. Hubbard.

Mr. HUBBARD. Thank you, Mr. Chairman.

Secretary Baker, we welcome you to our full committee hearing today and appreciate your remarks earlier.

You know, even though I am a Democrat and I am not an active foe of the Reagan administration I would mention that you might agree that the Reagan administration has done an about-face in its policy of international economic affairs.

During its first 5 years in office, the Reagan administration adopted a hands-off policy and, in fact, urged cuts in the amount of money the World Bank could lend to troubled countries.

Previous to now, the Reagan administration has urged that the private sector should be let alone to solve world economic problems.

Previous to now, the Reagan administration has emphasized the world debt crisis could be handled mainly between private banks and foreign countries with a minimum of U.S. help.

Could I ask you what caused this turnaround?

Secretary BAKER. Well, Mr. Hubbard, without necessarily agreeing that it is all that big a turnaround, let me say that, as I have indicated earlier, the new approach to the debt strategy, we think, is building upon the case-by-case approach.

We also think it is a private sector approach because we are talking about private-sector-type economic changes in the debtor countries.

But having said that, I think we have to say conditions change, and maybe conditions have changed. If we have changed courses, it is because conditions have changed.

Mr. HUBBARD. Mr. Secretary, how do you expect banks, many of which are caught up with the problems of our own economy and our own citizens' problems—take a rural area like mine—how do you expect banks to offer $20 billion for the next 3 years to foreign countries that are a bad economic risk and will not be a good investment?

Take the case of Mexico, a country which was reputed to be the International Monetary Fund's best turnaround case, having adopted austerity measures to reduce its government spending. Mexico is indeed bringing down inflation while increasing exports.

However, you feel recently the picture has changed in Mexico, what with the declining price of oil and the devastating earthquake which struck Mexico. How can U.S. banks be expected to make any new loans to developing countries when they already have risky loans outstanding and seem to be powerless to check unforeseeable disasters and changes that might occur in these debtor nations?

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Secretary BAKER. I don't think they will make new loans unless they see new policies in these debtor nations, and that is the fundamental basis for this whole new approach.

I might say, just so there is no misunderstanding, we use this $20 billion figure a lot—the $20 billion is worldwide.

The figure for U.S. banks is $7 billion, but I don't think there is anything unusual about a bank advancing additional credit to salvage a loan that is in trouble.

They will not do so under this approach unless they deem it to be in sheer self-interest.

If they don't deem it to be in their self-interest, there will be no new money forthcoming, but the fact of the matter is some of these banks have a lot of paper that is in trouble.

This, I think, offers them a way out.

Mr. HUBBARD. You mentioned we should remember we want to sell some of these countries our exports. Trade imbalance has been an issue before us. You state the United States has an obligation to stabilize the world economy.

How can I convince my constituents—24 counties in rural Kentucky—that we should finance growth in these foreign countries which are so quick to use our money to creat job-threatening trade imbalances?

Secretary BAKER. Quick to what?

Mr. HUBBARD. Job-threatening trade imbalances.

Secretary BAKER. I think you have to simply make the point that if we are going to export and if we are going to trade, there has got to be an open trading system in the world, and we have got to have healthy trading partners.

One reason that our trade deficit is as large as it is is because we are exporting less and less to the countries of Latin America be cause of the debt crisis.

That may be a hard sell, but it is the only sell I know.

Chairman ST GERMAIN. Mr. Wylie.

Mr. WYLIE. Thank you very much.

Mr. Chairman and Mr. Secretary, may I apologize for being late. I had a brief meeting scheduled which I couldn't change. But the chairman has told me you have had an excellent hearing, and I will be anxious to take a look at the record.

The big news from Korea, of course, was your proposal to induce commercial banks to increase their lending by $20 billion to highly identical countries, and may I say that I was in New Orleans at the bankers' convention on Sunday, and I couldn't find a whole lot of enthusiasm among the bankers down there for the proposal.

That is not to say that you aren't going to be able to use your persuasive ways to get them to do it, but I said in an interview that I thought it was probably a good idea to get these debtor countries to improve their economy, and the fact that you said the banks have an ox in the ditch—I come from the farm community, and I can relate to that.

If they can get through this period—and I guess this is your position—when these debtor countries cannot pay off their loans, and you can give them a little cash flow, you are sort of priming the pump so they can pay off their debts in the future.

That is the basic foundation of your argument, isn't it?

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Secretary BAKER. Yes, sir. But coupled with that, another key ingredient is they should adopt the economic measures that would permit them to grow sufficiently to pay those debts.

Mr. WYLIE. Maybe you have already answered this. You talked about the carrot approach, and that is the carrot approach.

Do you have other plans to induce the commercial banks—you apparently think this is very important from the world economy standpoint, to have the banks do this.

You are not asking for an IMF quote, an increase, as I understand it, but if the banks do this then you can call on the World Bank to do more, is that right?

Secretary BAKER. We can call on the World Bank to do more within the present budgetary constraints, yes.

Mr. WYLIE. Are you optimistic that will be enough to induce the banks to increase their loans by $20 billion?

Secretary BAKER. I think what will induce the banks is their determination it is in their self-interest to do so.

The key to that is going to be whether or not they think these countries will adopt these policies. If they don't think a particular country is going to adopt the necessary policies, I don't think there will be new money forthcoming.

Mr. WYLIE. Have you been asked what impact——

Secretary BAKER. May I just say one final thing?

We discussed this with some of the major lenders before Seoul. I might say that we ran this concept by them and we said, "What do you think," and they said, "We like the proposal, we like the concept, we like the idea."

I realize there are some members of these syndicates who would prefer to have it go away.

They would like to take their hickey and go down the trail on to something else.

I am sorry I interrupted you.

Mr. WYLIE. Do you know what effect Gramm-Rudman, if enacted, might have on the authorization bill which we passed which was referenced to the multilateral development bank?

Did anybody ask that?

Secretary BAKER. Yes, I was asked, I think, by Congresswoman Oakar whether or not it would be binding.

I think the answer to that is that our general counsel's opinion is that that would be in the nature of an irrevocable letter of credit and therefore would come within prior contract exemptions under Gramm-Rudman.

Mr. WYLIE. Thank you. Thank you, Mr. Secretary.

Secretary BAKER. My general counsel isn't here. I am getting this from somebody else. I don't want that to be definitive.

Mr. WYLIE. You want a caveat so you can revise your remarks later on?

Secretary BAKER. Yes, sir.

Chairman ST GERMAIN. Mr. Barnard.

Mr. BARNARD. Mr. Secretary, I am way down here in the corner.

Mr. Secretary, I hope I am not plowing old ground. I am sorry. I was taken away from the committee, but I want to ask you the three points of the program.

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Point No. 2 was the further involvement of the IMF and the World Bank, and the third leg of the stool was the further activity of the commercial banks.

What was the reasoning for not going to the IMF and the World Bank now as opposed to later for additional funding of the capital needs for these LDC's?

Secretary BAKER. Our thinking on that was if there is going to be any Federal funding for this, the worst thing we could do would be to lay that on the table up front.

We would never get the kind of commitments that we think would be desirable from the private banks, nor would we get the commitments on the part of the principal debtor countries to enact the necessary economic reforms.

And, finally, I suppose, I would say it was not necessary to do that at this stage since there is additional lending capacity within the World Bank as we sit here now.

Mr. BARNARD. That is the $2.2 billion—is that it? $2.7 billion, I think.

Secretary BAKER. No, sir; those are the trust fund reflows coming back into the IMF.

Mr. BARNARD. Which you are going to lend back out.

Secretary BAKER. Those are going to be used not for the principal debtor countries but the poorer countries, countries in Africa and countries like that.

Mr. BARNARD. In the very beginning of my hearing today, there was some question made as to what was the quid pro quo for getting these banks to involve themselves in further lending and, of course, you indicated, as I understand it, there was no quid pro quo. There was no forgiveness, so on and so forth.

I am just wondering, why would the banks want to—sort of to get back to Mr. Schumer's question—why would the banks want to get involved, especially at a time when the administration is advocating not only a reduction in their reserve for losses on loans, but in some instances eliminating their losses.

Why would the banks want to extend money to make more risky loans if this is a possibility?

Secretary BAKER. I think the banks would want to get involved because they have got a substantial amount at risk here. And I think that they might want to get involved because they would find it in their self-interest to do so.

I might say to you that we discussed this with some of the banks. But even before that, even before we discussed the proposal with them before going to Seoul, some of the banks came to us and said, "We really would like to see some leadership from the United States in this area. It is, after all, the world's largest economy, and we would like to see some leadership from the Treasury Department."

So, I think the banks have a self-interest here. You mentioned the elimination of a loan loss reserve as a part of the tax reform proposal. I think these two things are individual matters, and each ought to be judged on its own merits.

There was never any discussion of that until a meeting we had here 2 days ago with the banks at which some of the banks brought that up.

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Mr. BARNARD. I would think it would go hand and glove.

My memory is not so short. I don't remember several years ago when you and I and a number of others went together to put the IMF bill—extend the IMF bill. We didn't get a lot of support from some of the members from the other side, and the main reason was we were bailing out the banks.

That was the big theme of it. So, a number of us who knew better than that had to swallow our supportive IMF effort. This is what I can see in the offing all over again.

That is what worries me. In 2 or 3 years, are we going to be coming back, refunding the IMF and the World Bank and having to defend our position to do that by saying we are bailing out the big banks?

Secretary BAKER. I wouldn't think so, because as you have indicated by your first question, why didn't you put your Federal money up front?

This is clearly not a bail out of the big banks. There is not even any commitment here to come up with an additional Federal installment, if you will.

There is no Federal guarantee or commitment to go for a GCI. We made that very clear.

This is anything but a bailing out of the banks. We are asking them to come up with $20 billion in additional money.

Mr. BARNARD. Many of us on this committee are concerned about some of the big banks. I mean, we have had several narrow escapes with some big banks, and part of it had to do with riskier loans to LDC countries.

I feel like the administration—in asking those banks to do this and not being mindful of the fact they are riskier loans, do you stand on the position you don't think the reserve for losses of loans should be tax exempt?

Secretary BAKER. I sure do, particularly in light of the fact, as I indicated earlier, that some big banks are paying an effective tax rate of 6 percent.

So, I think that is a totally different issue and a totally different consideration.

But, let me say this. We are not saying come up with $20 billion worth of new money, banks. In the abstract, we are saying do it if you are satisfied you are going to get the kind of economic reforms that will enable these debtor countries to pay back the money they already owe you.

And if they get that, and they are going to exercise their own discretion. We are not twisting any arms. Somebody suggested here a minute ago that the vote that we had to eat in Ways and Means the other day on the loan loss reserve was somehow a quid pro quo.

The answer to that is definitely not. We still want that as a part of tax reform.

Mr. BARNARD. I wouldn't admit it anyhow, that you lost it.

Let me say this. I think that your statement on that is very clear, and I have no problem with it. If this is going to be a judgment the banks are going to make individually, they are going to live or die by those judgments, and I hope as we have to address some other matters in Congress, such as deposit insurance reform, expanded powers, they are not going to come running to us and

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say, "OK, we did this thing. We are going to get this, that and the other."

If they haven't made a deal with the Treasury at this point, I don't know they have made a deal with this committee.

Secretary BAKER. They haven't made any deal with Treasury. This is something—let me say it for the 24th time. If it is in their self-interest, they are going to do it. If it is not, they are not going to do it.

Some of them have said they like the idea of this proposal. They would like to see if they could make it work.

Mr. BARNARD. My only problem with that is what I have read. It looks like to me Chairman Volcker may be putting the strong arm on some of them. By that, what I have read, with all those meetings and some of these conversations, I am delighted to hear what you said—it is going to be up to the banks to make those decisions.

Secretary BAKER. Yes. There have only been three meetings. They were called for the most part at the request of the banks. In fact, the third one, the one he just had down in New Orleans, grew out of the second, the second out of the first one.

It has been at the banks' request that we have had those meetings.

Chairman ST GERMAIN. May I say to Secretary Baker, I want to give you a little help, Mr. Secretary, with these banks.

You said they would exercise their discretion on this additional $20 billion. I want you to know they are brilliant. We had, on April 6, 1977, three of the most—in combination since I won't ascribe all of those traits to each one of them but in combination—pompous, egotistical, overbearing, arrogant, condescending individuals ever to appear before our subcommittee.

I will quote from their comments on April 6, 1977, before the Subcommittee on Financial Institutions. The subject of the hearings was international banking operations.

Mr. Alvin Rice, vice president, Bank of America:

> And I would like to explain my own strong belief that the country's banking system is strong, resilient, fully capable of dealing with the essential, well-trained and the essential immediate term lending we do without jeopardizing the needs of the American people or the safety of the money they entrust to us.

Then, we go to another brilliant gentleman who says to us—oh, yes, vice president of Chase Manhatan Bank, Mr. John C. Haley. What does he say?

> We have a fundamentally sound foreign asset portfolio. It is sound because we work hard to keep it that way, because we have no intention of allowing the quality of our foreign portfolio to deteriorate. I expect certain categories of farm loans will grow less rapidly in the future than they have in the last few years.

Lastly, a Mr. G.A. Kostansko, vice chairman, Citicorp and Citibank. What does he say? He says:

> Because there appears to be widespread concern over the volume of international lending by private banks, I am glad to have the opportunity to be here. I wish to stress I see nothing in the overall global economic and financial situation which gives any credence to news stories predicting generalized default by LDC's. In fact, I know of no developing country that cannot serve its private debt, a notion LDC's are a disaster area simply does not square with the facts.

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You can remind those people what they said to us at that point in time. They are brilliant, they are all knowledgeable. They can look into the future, have crystal balls, and tell them to get those crystal balls out and help you solve this dilemma. They probably all since have been fired.

Mr. Wortley.

Mr. WORTLEY. Thank you.

We are glad to have you with us, Mr. Secretary.

I want to get what the response was last Thursday when you met with 25 or so CEO's. What was their reaction to the proposal when you explained it?

Were they interested in explaining further foreign lending?

Secretary BAKER. Mr. Wortley, as I indicated earlier, I think the reaction of the banks has been generally positive to this approach. There are clearly some members of these syndicates who would like to write the loan off their pages and forget about it, take their loss and go on about their business.

There are some that, quite frankly, I think are in a bit deeper than that, and they are interested in means whereby they might work their way out.

I think they view this as a proposal having merit.

Mr. WORTLEY. When we consider the obligations they have to their shareholders as well as to their depositors, in view of the—I will call it the brinksmanship we seem to run into about every 3 months, at the end of each quarter, and then we have genuine crisis management at the end of each year as to how we are going to handle the unpaid interest, unpaid principal on these foreign loans.

I suspect that there is a basic reluctance on the part of many of these institutions to make further commitments to Third World countries.

Now, the question I would like to pose to you: Is there some merit to the creation of the so-called superbank to achieve your desired goals?

Secretary BAKER. Well, let me first make sure you understand that the term "superbank" is not a term as far as I know anybody in the Treasury Department has ever used, nor for that matter, a term any banker has ever used.

It is a term a headline writer for the Washington Post used, and it does not adequately describe what I think would be simply an administrative facility designed to assist in the handling and operation of these loans to lesser developed countries.

It would simply be an administrative device to avoid having 150 banks agree to every jot and title of each lending agreement. The banks would put their money into the facility, and the facility operating through one board of directors or one professional staff would negotiate the loan.

It is a purely administrative device.

Chairman ST GERMAIN. Will the gentleman yield.

You have the lead bank today that makes the loans, right, and the little banks don't know diddley-do about what is going on, anyway?

Secretary BAKER. Each one of those little banks has to agree to each and every term.

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Chairman ST GERMAIN. They did because they didn't understand it in the first place.

Thank you.

Mr. WORTLEY. By forming some sort of consortium and calling the superbank or whatever else, aren't they, in effect, spreading the risk somewhat?

And that is the grave concern here, whether an individual bank makes a loan to Mexico or Argentina, Peru, Chile, or whoever else, they are concerned about the high level of risk, and by forming a consortium, don't they, in effect, spread the risk somewhat?

Secretary BAKER. Not if you had a consortium for each particular country, for instance. I mean, the idea has never really been totally fleshed out.

It was an idea Chairman Volcker had. There are many problems with it, because you have some of these banks with loans to Bolivia and some without, and they are not going to want to put their money up if they know it is going to Bolivia, and that sort of thing.

It is something banks are looking at as an administrative device. It is not something we are going to be involved in. There is no Federal money in it. It is not a superbank. It will not have its own ability to generate funds other than through banks that are participating in these loans to the principal debtor countries.

Mr. WORTLEY. Would you put your blessing upon it if that were the only way to achieve further commitment?

Secretary BAKER. If it would ease the administrative problems of dealing with all these countries and all these banks, if it looks good to the banks, then we certainly have no objection to it.

It is not something we are sponsoring.

Mr. WORTLEY. Thank you very much, Mr. Secretary.

Chairman ST GERMAIN. Mr. McCandless.

Mr. MCCANDLESS. Thank you, Mr. Chairman.

Mr. Secretary, I would like to add to that of my subcommittee chairman, Mr. Lundine, my compliments to you and the Treasury Department for a new direction, so to speak.

I would like you to expand on a part of your——

Chairman ST GERMAIN. Mr. McCandless, Secretary Baker is a very shy fellow, even though he is a Texan. That is very unusual.

Mr. Bartlett hasn't asked any questions. Secretary Baker was supposed to leave at 3:30. Could you split your 5 minutes with Steve Bartlett?

Mr. MCCANDLESS. I think we can accommodate him. We are always willing on this side, Mr. Chairman.

Have you got that?

Chairman ST GERMAIN. I always cooperate, too.

Mr. MCCANDLESS. Right.

In your address, you talked about progress that has been made by the kind of program you are talking about here in that you said in the last 3 years the international finance community had developed a cooperative case-by-case strategy, and that in the 3 years aggregate, current accounts deficit had been sharply reduced from $104 billion in 1982 to $44 billion this year, 1984, and that the growth in the developing countries had been restored to about 4 percent compared to less than 2 percent previously.

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If we can take this as a beginning point in the 2 minutes I have left, what are you proposing currently in your policies that were maybe not a part of the 1982 to 1984 time line in which this progress was made?

Secretary BAKER. We are proposing a use of additional unused World Bank capacity.

Mr. MCCANDLESS. These are the funds not lent that have been kept in reserve for various reasons?

Secretary BAKER. Just lending capacity not used.

We are suggesting using that in the context of structural adjustment lending as opposed to balance of payment lending which the IMF supervises.

We are also talking about new flows of private bank money which, of course, there has been some in the past, but it is keyed to that structural adjustment lending.

Mr. MCCANDLESS. The concern I have here is structural in nature with respect to the World Bank, the development banks, and the private sector institutions.

Have we a plan that will attempt or in some way address a needed coordination between these various structures in one single effort toward one single nation or region?

There has not been this before. In the limited time I have been on this committee, and following some of those loan applications, I have found the World Bank does one thing with one country, the Inter-Development Bank does another, and they don't check with one another.

Is there a coordinated activity being developed?

Secretary BAKER. No, sir; but the implementation of this proposal will, I think, require that.

Certainly it will argue for that, if it doesn't, in fact, require it. If we are going to make this work, we have to have that kind of implementation process.

Now, it is that that we are in the process of developing, and that is why this is not going to be something that is going to be done over a very short period of time.

Mr. MCCANDLESS. How much would you say, off hand, is available in the World Bank and those development banks that has not yet been used in recent times that could be allocated given the proper criteria in the form of loans?

Secretary BAKER. The figure is $9 billion over the 3-year period as far as the World Bank is concerned.

Mr. MCCANDLESS. Thank you, Mr. Chairman.

I have been advised my time has expired.

Chairman ST GERMAIN. Mr. Bartlett.

Mr. BARTLETT. Thank you.

Mr. Secretary, as you can tell, there is a good deal of enthusiasm, I think, and support for the package and the direction that you are proposing here today.

You have said, as you said earlier, 24 times, that there are no guarantees implicit or explicit to the additional lending by the private banks, so I won't ask you to say it a 25th time other than to note, as you can tell from the questions, a good deal of support for no implicit guarantees.

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My question is the nature of the investments or lending that would be done in the debtor nations. There have been some suggestions and proposals about the debtor nations and the lenders would be far better off with smaller loans, not the large big steel manufacturers' kinds of loans, but the smaller loans that, in fact, could create a faster growth in the countries.

Do you see any movement either by the lenders or by the debtor nations to open up their markets or by the lenders to send in country bankers to those countries to make the smaller more entrepreneural kind of loans?

Secretary BAKER. I cannot speak as far as the private bankers are concerned whether they would be inclined to do that.

I suppose they would be. We are talking about less in the nature, I think, of project loans than we are the type of loans that you are suggesting, at least as far as the multilateral institutions are concerned.

So, I would agree with you as far as they are concerned. I cannot speak for the private lenders. We are really talking here about their loans to the public sector in those countries, not loans to the private sector.

Mr. BARTLETT. Thank you, Mr. Secretary.

Chairman ST GERMAIN. Mr. Secretary, a parting question. I note you said your General Counsel told you as far as the multilateral development banks are concerned, they would not be adversely affected by Gramm-Rudman as it now stands, because it is, in your opinion—in their opinion—in the nature of a letter of credit.

I would hope that you would stay on top of this very closely, because we have a concern as well with FDIC, FSLIC—that is the insurance of $100,000 deposits per individual, and a lot of my constituents in Rhode Island are very concerned about the adverse—possible adverse effects of Gramm-Rudman.

Would the bill as it is written—not as the Senate staff says it is, but as it is written—would it indeed mean there could be a bank failure and as a result, instead of $100,000, they get $71,000 coverage?

So my question to you is, if those funds, insuring funds, are adversely affected, if the multilateral development banks would be adversely affected, would you still support Gramm-Rudman, or do you think we have to look at it a little more to make sure this doesn't happen?

Secretary BAKER. Well, Mr. Chairman, let me say this. First of all, I have said I am not sure they can give you a definitive answer, because I don't know what changes are going on in that conference right now.

Chairman ST GERMAIN. Will you have your brilliant, intellectual, superduper legal staff watch that very carefully and give us an instantaneous answer when they come to a conclusion.

Secretary BAKER. When Gramm-Rudman is enacted, we will have an answer.

Chairman ST GERMAIN. Before it is enacted, how can we vote intelligently?

Secretary BAKER. We can give you an answer before the conference report comes to the floor.

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Chairman ST GERMAIN. That is my question. By the way, for the people of the nation, we want to be able to assure them their deposits are insured up to $100,000 before we vote.

Secretary BAKER. As the conference proceeds, yes, sir, we will be able to do that.

Chairman ST GERMAIN. Mr. Secretary, we thank you kindly again for coming up on such short notice. I assume you realize there is a great deal of interest by the members of the committee in your new initiative.

Secretary BAKER. Thank you, Mr. Chairman.

[Whereupon, at 4 p.m., the committee was adjourned.]

[In response to the request of Members of the committee submitting written questions, Secretary Baker's replies follow:]

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DEPARTMENT OF THE TREASURY
WASHINGTON

15 NOV 1985

The Honorable
Robert Garcia
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Garcia:

Thank you for your letter of October 24, 1985 to Secretary Baker in which you raise certain questions based on his testimony before the Committee on Banking, Finance and Urban Affairs.

Your first question concerns the tax incentive for investment in Puerto Rico and the U.S. possessions. We share your view that it is important to foster stronger sustained growth in Puerto Rico. The Administration's proposal to replace the existing tax credit for possessions source income with a wage credit was motivated by concern that the existing credit is not accomplishing that objective in Puerto Rico. The tax costs are high and rising but too much of that benefit goes to the companies as a return on intangible assets and not enough to the economy of Puerto Rico in increased employment. The proposed wage credit would directly reward employment in Puerto Rico. Moreover, because the credit could also be used against the tax on U.S. or foreign income, it would be attractive to a wider range of firms, not only to those able to generate very high profit ratios in Puerto Rico.

You ask whether we can expect developing countries to adopt supply-side policies. The adoption of longer-term supply-side, market-oriented policies seems essential to promote growth. Sustained growth will depend in large measure on the ability to generate greater domestic savings, to encourage additional investment from abroad.

We think that other countries will scramble to adopt supply-side policies if they are convinced that the results would be the same as we have seen in this country over the course of the past 34 months. We are in the longest economic expansion since the Korean War and have more Americans working today than ever in our history.

In fact, we were surprised in Seoul to find a broad willingness to embrace growth-oriented policies among the industrialized countries and the developing countries as well. From our point of view, the adoption of growth-oriented reforms would be a prerequisite for increased MDB adjustment support.

You also ask about our position on lending to Chile in the light of the human rights situation. The Chilean situation is certainly not what we would wish it to be. We have strongly encouraged progress toward a transition to democratic government.

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The Administration believes there was a distinct improvement in June when the Government of Chile lifted the state of siege. We have taken that particular factor into account in resuming our support in recent months for MDB loans to Chile that do not meet basic human needs.

Sincerely,

(signed)
Bruce Thompson, Jr.

Bruce E. Thompson, Jr.
Assistant Secretary
(Legislative Affairs)

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Questions and Responses Submitted for the Record of
the Committee on Banking, Finance and Urban Affairs

CHAIRMAN ST GERMAIN: The events in Seoul appear to represent a significant reassertion of American leadership in international financial and economic area. Could you explain to the Committee what changes occurred in the international economy recently which have brought about this more activist U.S. policy?

SECRETARY BAKER: In preparing for the IMF/World Bank Annual Meetings, it became apparent that the international debt strategy needed to be strengthened in order to consolidate gains achieved over the past three years and to improve growth prospects in the less developed countries. In particular, there was a need to address three related issues.

- first, although developing nations were on the whole successful in achieving external adjustment, a number of principal debtors were less successful in implementing internal reforms necessary to restore long term, non-inflationary growth.

- Second, there has been a sharp decline in net new commercial bank lending to less developed countries, even in cases when these countries were undertaking adjustment in conjunction with IMF programs.

- Third, as we move into the next phase of the debt strategy, it was clear that many of the serious economic problems facing less developing countries were long term and structural in character, and it would be necessary to involve the multilateral development banks more actively in addressing these problems.

The "Program for Sustained Growth" is intended to deal with these problems in a comprehensive and coordinated manner in which each participant -- the principal debtors, commercial banks, and international institutions -- must do its part so that all can benefit from increased growth.

CHAIRMAN ST GERMAIN: You are addressing two quite different problem areas of the world with separate initiatives, i.e., (1) the low income countries of Africa with "protracted balance of payments problems" and heavy debt burdens, especially to the IMF, and (2) the heavily indebted middle-income countries, as in Latin America. Both initiatives are similar in that they appear to be designed to return these countries to a growth path.

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With respect to the first, could you elaborate on how you expect the IMF and Bank policies to be meshed? In particular, would the Bank's long-term development objectives be given greater weight than in the past given the special problems of Sub-Saharan Africa?

SECRETARY BAKER: Our key objective is to use external resources as efficiently as possible. By encompassing joint IMF and World Bank programs and financing, we hope to ensure a comprehensive country approach which would address both macroeconomic and structural requirements. Our aim is a single, consistent and mutually supportive set of policies which would deal with Sub-Saharan Africa's short-term difficulties in a way which would strengthen the foundation for longer-term development.

CHAIRMAN ST GERMAIN: Could you provide additional details on where the funds would come from to "match" the $2.7 billion reflows from the IMF Trust Fund, including how much would come from the World Bank? How much, if any, would come from the United States, and how much from others? Would any of these funds be net additional funds over previously projected contribution levels?

SECRETARY BAKER: We would look to the World Bank to provide perhaps $2 billion of resources over the 1987-91 period through transfers of IBRD net income, additional IBRD lending to the more creditworthy countries, and allocation of IDA resources to Sub-Saharan Africa.

In addition, we would consider seeking direct funding for the joint program if other donors were prepared to make equitable contributions. We are exploring the possible magnitude of donor contributions which might be available.

Apart from the Trust Fund resources, the Sub-Saharan African countries would be receiving net additional funds from all these sources.

CHAIRMAN ST GERMAIN: With respect to the Latin American middle-income countries, how exactly do you envision the private commercial banks, the countries themselves and the multilateral banks coordinating the respective roles you have suggested for each? What will be the mechanics of making this three-legged agreement move forward?

Specifically, what is the current status of efforts to persuade the commercial banks to increase their lending? Have concessions or promises been made to them in the context of the ongoing meetings to discuss this proposal? Are the banks being asked to further stretch out or relieve debt service payments? Despite your clear testimony on this point, press reports still convey commercial bank interest in some sort of "superbank" proposal. Could you explain what the banks advocate in this regard and the Administration's response to their position?

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SECRETARY BAKER: I expect that the three prongs of the Program will come together in individual agreements reached by the countries with the IMF and IBRD which set forth policies to be implemented by the countries, amounts of lending to be provided by the institutions and anticipated financing flows from other sources, including private banks. The private banks would in some manner endorse the amount of net new lending foreseen for them in each specific agreement, and subsequently sign loan agreements with borrowers in the country.

We look to the banking community to formulate their own response to the Program I proposed and, assuming their agreement, to coordinate their contribution. I believe their reaction has been positive, and understand that banks in the United States and other countries are discussing how to articulate their position.

Concessions have not been promised to the banks, nor to any other participants. I anticipate that all participants will do their respective parts because it is in their own basic self interest to cooperate.

We have not made specific suggestions to the banks beyond what is described in my prepared statement. Whether some or all of the banks wish to coordinate their new lending by some form of pooling procedure is a matter for them to decide.

CHAIRMAN ST GERMAIN: If the various parts of this package were to "come together" as you hope, what additional resources do you expect would be needed for the World Bank to play the expanded role you are suggesting? What steps are you taking to encourage the Bank to assume this larger role?

SECRETARY BAKER: We have discussed strengthening the World Bank's role with Management and with other members of the Bank and are encouraged by the support which they have expressed for the approach recommended by the United States. We are also encouraging the principal debtor countries to work with the Bank in developing the growth-oriented adjustment programs necessary for increased Bank support.

If all elements of the package "come together", we are prepared to look seriously at the timing and scope of a general capital increase for the IBRD. The extent of future demand for quality IBRD lending would be one of the key factors in determining the parameters of any new capital increases.

CHAIRMAN ST GERMAIN: What do you see as the proper mix of Bank and Fund roles in the new orientation toward growth in the Latin economies? What are the Latin governments' views on these issues?

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SECRETARY BAKER: As I have noted already, we envisage a continuing central role for the International Monetary Fund (IMF). Through both its policy advice and balance of payments financing, the IMF has supported needed policy changes and encouraged capital inflows. It must continue to do so.

We also see a greater role for the World Bank and the Inter-American Development Bank (IDB). These institutions have considerable scope to expand structural adjustment and sector lending within current programs and resources. We are convinced that these resources can be disbursed more quickly and can be targeted more effectively to provide the needed support for growth-oriented policies.

Sustainable, non-inflationary growth will not be easy to achieve. It will require structural changes designed to reorient the economy and will require patience and courage. But, the rewards are worth the effort:

-- New industries where there is a comparative advantage;

-- New tecnologies;

-- A more efficient, liberalized trading system;

-- More efficient and rationalized domestic financial markets;

-- New freedom to the private sector;

-- New efficiency in providing many government services.

The Latin American countries in general have strongly welcomed our proposals designed to improve the prospects for sustained growth in the region. While they recognize the political difficulties they will face, the Latin American governments will understand that it is in their own interests to implement economic programs that will lead to higher growth, price stability, and efficient use of their many productive resources.

MR. LUNDINE: The Subcommittee on International Development Institutions and Finance will hold hearings next month on the Administration's human rights policy with respect to the multilateral development banks. At that time, we will hear from the State Department. To complete the record of your testimony, however, please describe the Administration's view as understood by the Treasury on whether the United States should ever vote to support lending to a regime guilty of "a pattern of gross" violations of human rights.

SECRETARY BAKER: Public Law 95-118, as amended, clearly requires the U.S. Executive Director of the multilateral development banks to oppose loans to any country that is identified as engaging in a pattern of gross violations of internationally-accepted human rights. Under this Administration and under preceding Administrations as well, the United States has at various times opposed MDB loans to a number of countries on the basis of human rights considerations.

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Opposition to the loans in question has been taken as a matter of policy and in light of the legislation that exists. It has never entailed the identification of any country as a "gross violator." This was the case under the past Administration and it has been the case under this Administration.

The U.S. Executive Directors at the multilateral development banks receive instructions on all loans that are under consideration. All of the loans including those to Chile, are considered on a case-by-case basis and human rights considerations are taken fully into account as well as economic and financial criteria and other legislative provisions that pertain to such matters as expropriation of U.S. property and financing for commodities in surplus on world markets that may injure U.S. supplies.

MR. LUNDINE: In discussions concerning the Administration's Seoul initiative, private U.S. banks reportedly have expressed interest in obtaining some sort of regulatory relief or relaxation in conjunction with their increased lending to the developing countries. What regulatory or bank supervisory relief or relaxation have the banks requested or suggested in the context of your Seoul proposals? What is the position of the Department and the Administration on the need for or acceptability of each such proposal for regulatory changes?

SECRETARY BAKER: Some individual banks have expressed general concern about potential inconsistencies between bank examiners' attitude toward concentrations of exposure in heavily indebted countries and the suggestion that the banks lend additional funds to some or all of these countries. However, no specific proposals have been advanced on this issue.

I see no need for any significant changes in the general regulatory framework. As I mentioned in my oral statement, U.S. regulatory agencies are on record as stating that, in appropriate circumstances, new lending can help to improve the quality of outstanding credit. This is a very important point. Given this fundamental regulatory stance I am confident that it is possible to iron out any inconsistencies that might arise in specific examinations.

MR. LUNDINE: In response to Rep. Fauntroy's questioning, you indicated that the Administration continues to believe that the level of U.S. bilateral assistance is sufficient to justify the ongoing U.S. refusal to participate in the Special Facility for Sub-Saharan Africa. Yet the Administration has requested $75 million to be used to support policy reform efforts in Africa (administered bilaterally through AID) this fiscal year, and proposes to make those resources available in cooperation with, but not directly through, the Special Facility.

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That approach has several unfortunate consequences. Non-participation in the Special Facility means the U.S. expenditure does not achieve the same leveraging effect of encouraging other nations to contribute, thereby lessening its actual cost-effectiveness; it is also generally accepted that multilateral institutions are generally superior to their bilateral counterparts at achieving policy reform in the recipient countries, which is a key objective of the Administration's Seoul initiative; non-participation also needlessly deprives U.S. businesses of the right to compete for procurement contracts issued for all of the Special Facility's total committable resources of $1.4 billion; finally, the U.S. refusal to participate in the Special Facility has reduced the willingness of other donor nations to participate in the new African Trust Fund and related initiatives you proposed at Seoul.

Please comment on each of these consequences of the current U.S. position and explain why U.S. participation in the Special Facility is not now justified in light of the changed circumstances since U.S. participation was initially solicited.

SECRETARY BAKER: Rather than participate in the Special Facility, the United States preferred to concentrate on improving the impact of our bilateral program and enhancing the effective use of existing multilateral resources.

U.S. bilateral assistance to Sub-Saharan Africa continues to exceed $1 billion in FY 1986, excluding emergency assistance. We are also the largest single contributor to the World Bank, and we are working with Management and other members to improve the effectiveness of the Bank's assistance efforts in Africa. We have successfully encouraged greater IDA focus on Sub-Saharan Africa, with the region now projected to receive 37 percent of IDA VII (FY 85-87) resources. This compares to the 32 percent share Sub-Saharan Africa received in IDA VI (FY 81-84). In addition, the United States is also a major contributor to the African Development Bank and Fund. We view this U.S. response to Africa's difficulties as positive and forthcoming.

U.S. participation in the Special Facility at this time would do little to generate additional resources for Africa. Other donors have already fixed their contributions to the Facility, and do not seem inclined to extend its life beyond FY 1987.

In our view a joint program based on the IMF Trust Fund reflows offers a far more realistic approach for catalyzing additional resources and increasing the flow of concessional financing for Africa.

MR. NEAL: Mr. Secretary the developing countries provide a a larger export market for U.S. products than all the industrialized countries combined, except for Canada. Over 40 percent of U.S. exports of goods and services have gone to LDCs. It is estimated that each $1 billion of exports generates 25,000 U.S. jobs, making exports of enormous significance to U.S. employment.

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U.S. banks are the primary source of financing for U.S. trade. The costs banks incur are reflected in the final cost of U.S. exports. They cannot afford increases in the cost of doing business, especially when foreign competitors do not incur the same costs.

The Administration has proposed changes in the foreign tax credit that will increase revenue by $13 billion by 1990. This is an added cost that our foreign competitors will not have to bear.

If your plan to stimulate the Latin American economies works, will the benefits to American exporters be offset by the tax increase the Administration has proposed? Will foreign competitors take business from U.S. exporters because of this increased tax?

SECRETARY BAKER: Your description of the revenue impact of the President's proposal to modify the foreign tax credit presents only half of the picture. The President's tax reform proposal also recommends a sharp decrease in the corporate tax rate. That rate decrease would apply fully to U.S. taxpayers' foreign source income. When the revenue impact of the tax rate reduction is considered together with the revenue effect of the Administration's other proposed changes directly affecting foreign commerce, the result is a net reduction in the amount of U.S. tax on income derived outside the United States. Accordingly I do not believe that the President's tax reform proposal, viewed in total, will adversely affect the competitive position of U.S. companies abroad. As we consider tax reform with Congress, we will continue to be mindful of the need to preserve the competitive position of U.S. companies in foreign markets.

MR. NEAL: Mr. Secretary, your debt strategy will require debtor countries to implement new policy reforms, in addition to those adjustment measures required by the IMF. Could you describe more fully what those policies might be for a country such as Mexico? What, concretely, should Mexico now be expected to do? Who will formulate these demands -- the IMF? The World Bank? The U.S. Government -- and make sure they are being carried out?

SECRETARY BAKER: Debtor countries who need additional funds will have to undertake structural adjustments in their economies to ensure that these funds will be put to good use. The IMF's primary focus is on short-term reform, e.g., balance of payments adjustment. Structural reform takes longer, so it cannot be adequately addressed in IMF programs. For this reason, we would like the multilateral development banks (IBRD and IDB) to take a more prominent role in economic reform through structural adjustment and sector loans. Mexico needs first an IMF program with appropriate macroeconomic targets and, second, development loans from the IBRD and IDB that are soundly conditioned on needed reforms. The IMF program would primarily help control inflation and the budget deficit, but would also take the lead on exchange rate and trade subsidy issues. We would expect that the IBRD and IDB would take the lead in sectoral reforms to lay the basis for healthy, long-term growth.

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MR. LEHMAN: It is quite clear tha that the continued high population growth rates in the LDCs have a direct bearing on the international economy by absorbing real resources, increasing immigration and labor problems, and further exacerbating trade imbalances and deficits. Will this new approach include incentives to stabilize population growth? Do the MDBs presently have the authority to condition loans with incentives to stabilize population growth and, if not, will the Administration encourage such a provision as part of its international debt proposal? If so, what types of population stabilizing incentives wll be advocated?

SECRETARY BAKER: Population growth clearly has a bearing on longer-term economic prospects in developing countries. Governmental efforts to affect population growth rates require taking into account the cultural practices n a country and, to be effective the circumstances in individual families. Such efforts are necessarily complex and require careful, sensitive preparation. In instances, the MDBs have assisted countries in the past and, we expect, will continue to offer appropriate assistance.

Population policies will succeed if a natoinal consensus acknowledges their need. Post efforts to impose policies in the absence of a consensus have not been successful.

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